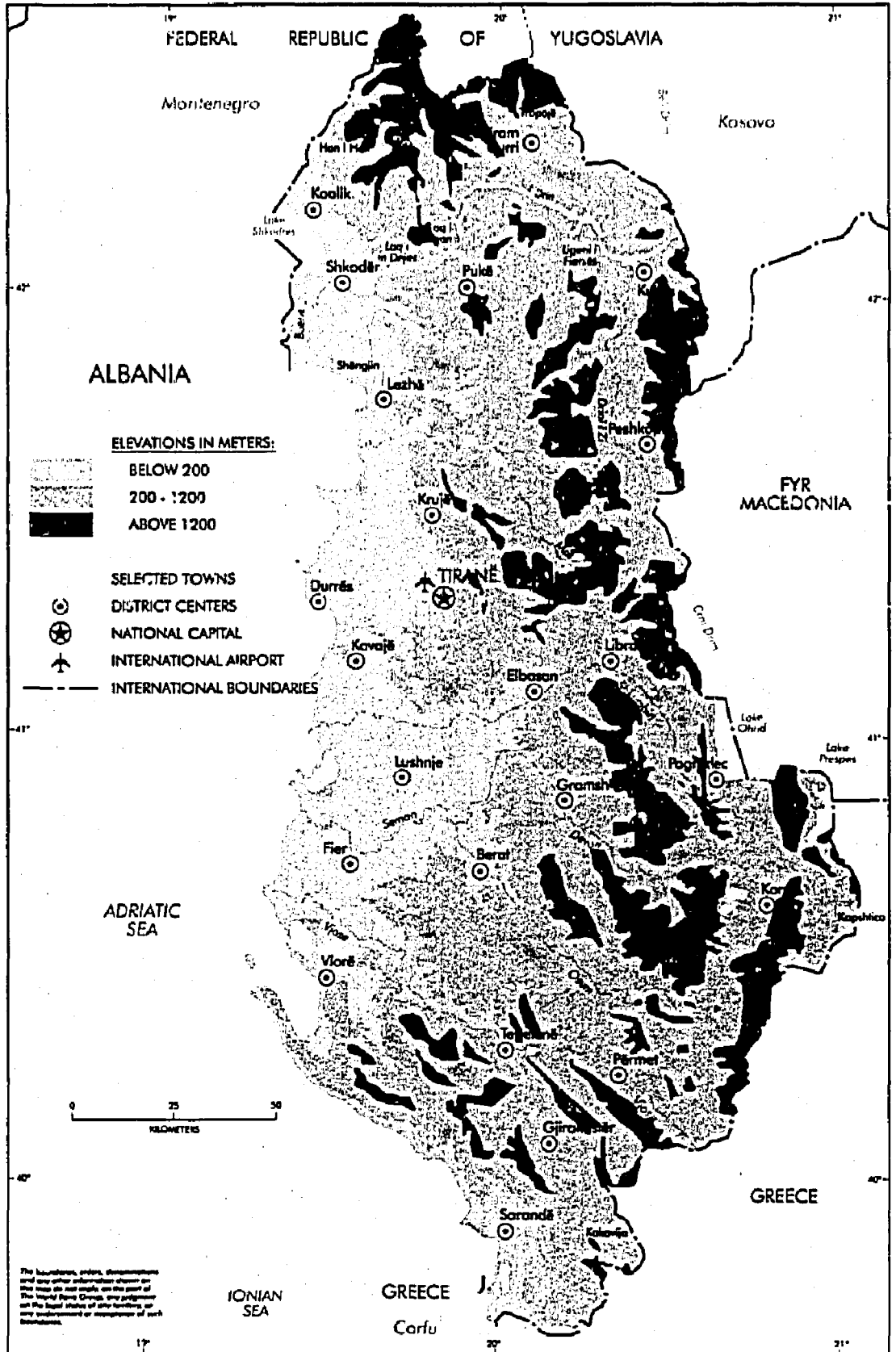


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ALBANIA AND THE WORLD BANK

BUILDING THE FUTURE







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THE WORLD BANK
Washington, D.C.

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Contents

Introduction	1
Historical Perspective	1
Economic and Political Revolution	6
The World Bank in Albania	10
Notes	16
Investment in Infrastructure	17
Transport	19
Water, Sanitation, and Energy	24
Housing	28
Telecommunications	29
Agriculture	33
Land Policy	36
Agricultural Infrastructure and Services	38
Price Policy	43
Fisheries and Forestry	44
Alleviating Poverty and Supporting Human Resources	48
Poverty Alleviation	50
The Labor Market and the Social Safety Net	54
Health Services	59
Education	61

Supporting the Development of a Private Sector	64
State Enterprise Sector	65
Developing a Financial System	74
Looking Forward	79
Successes	81
Challenges	84



INTRODUCTION

Between the end of World War II and 1990, Albania endured one of the most authoritarian regimes in history. A combination of strict central planning, isolationism, and totalitarian control over every aspect of life blocked economic and social development. In 1990 the Communist regime started to disintegrate. After two years of chaos, a complete economic, political, and social transformation process started in earnest, following the first truly democratic elections, in March 1992. This booklet describes the beginnings of Albania's cooperation with the World Bank Group.¹ It is our hope that the programs and projects described here will lead to growth and greater prosperity for the Albanian people.

Historical Perspective

Today's Albanians, primarily descendants of the ancient Illyrian tribes who settled in the region in the seventh century B.C., are a non-Slavic people with Indo-European ethnolinguistic roots. The country's population is estimated to be 3.5 million, and another 3 million ethnic Albanians live in parts of the former Yugoslavia. Over the centuries, Albanians emigrated to many parts of the world, and there are people of Albanian ori-



In Skanderbeg Square, Tiranë

gin in North America, Europe, the Middle East, and even Australia. The religious composition of the country is estimated at approximately 70 percent Muslim, 20 percent Christian Orthodox, and 10 percent Catholic. In Albania these religions have coexisted in an atmosphere of mutual tolerance, although all religious practice was suppressed during the Communist regime. Today Muslim and Christian religious feasts are celebrated equally. The president comes from a Muslim family and the prime minister from a Christian Orthodox one. Albania is a member of the United Nations, the Council of Europe, the Conference on Security and Cooperation in Europe, the Organization of Islamic States, and the Partner-

ship for Peace program of the North Atlantic Treaty Organization (NATO).

The area of present-day Albania became a part of the Ottoman Empire in the 1470s after a twenty-five-year resistance led by Gjergj Kastrioti-Skanderbeg, an Albanian national hero and a skillful general admired by Albanians and Ottomans alike. Until the early twentieth century, the territory comprising modern-day Albania remained under Ottoman administration.

During the Ottoman period many Albanians converted to Islam, and a large number became high-ranking officers in the Ottoman army or the imperial administration. Inter-marriage between Albanians, Turks, Bosnians, Macedonians, Bulgarians, and other groups in the Ottoman Empire was frequent, and many of the most famous figures of modern Ottoman history had Albanian roots. Mohammed Ali, the founder of modern Egypt, who almost succeeded in taking over the entire Ottoman administration from his base in Cairo, was an Albanian. Ali of Tepelenë, another powerful Albanian-Ottoman, came close to creating a modern Albanian state in the early 1800s. Albanians were strongly represented both in Mithad Pasha's Tanzimat movement, which attempted to reform the Ottoman Empire in the second half of the nineteenth century, and in the Union and Progress Committee formed in Macedonia. The latter organization was pivotal in the 1908 revolution, the proclamation of a constitutional monarchy in Istanbul, and ultimately, after World War I, the Kemalist revolution that created the modern republic of Turkey. It is important to stress this aspect of Albanian history, for it illustrates how Albanians took part both in high-level public administration and in attempts at radical socioeconomic reform.

The question of Albanian national lands was first addressed by the Prizren League in the 1870s. The league did not seek establishment of an Albanian state, but one of its priorities was to prevent foreign powers from infringing on Albanian-inhabited lands. The 1912 London Conference on the Balkans created an Albanian state, but without the Albanian-inhabited areas of Cameria in the south and Kosovo in the north. The

country's first government was formed by Ismail Qemal, who had been one of Mithad Pasha's favorite lieutenants during the Tanzimat period. Qemal had distinguished himself as one of the most efficient and modernizing Ottoman administrators before he turned his energies to the creation of an independent Albania, having given up hope that the Ottoman Empire could be turned into an effectively functioning multinational federation.

The years between World Wars I and II were fraught with internal political instability as a result of regional tensions within the country and foreign influences on domestic politics. Archbishop Fan Noli, a Christian Orthodox clergyman and politician, wanted his country to move beyond regionalism and clan issues. He advocated a Western-style government that would provide social services and promote agricultural reform, political liberties, and resistance to foreign pressure in domestic politics. However, Noli never had an opportunity to implement his reforms. He was installed as president in June 1924 and in December was ousted from office by his political rival Ahmed Bey Zogu.

Zogu introduced a repressive regime, outlawed political opposition, and ultimately declared himself King Zog. Beginning in the mid-1920s, the Italian government signed economic and foreign relations treaties with Albania and provided large financial subsidies to the Zog regime, ensuring a dominant position for Italy in Albania. In the spring of 1939 the Mussolini government forced the Albanians to sign additional agreements. These led to Italian annexation of Albania and to surrender of the royal crown to Italy's King Victor Emmanuel III.

The World War II years were turbulent for Albania under Italian occupation. The National Liberation Movement, formed in 1942, was associated with a Communist group led by Enver Hoxha. The conservative nationalist group known as the Balli Kombetar was organized under a program calling for union of the Kosovo territories with Albania and the exclusion of King Zog from any postwar government. After Italy surrendered Albanian territories in September 1943, German troops

invaded the country and set about forming a government sympathetic to the Balli Kombetar. However, when the German forces left Tirane in 1944, the government fell. Following a brief civil war, the National Liberation Movement formed a new government with Enver Hoxha as its leader.

The post-World War II years began with a close alliance between Marshal Tito's Yugoslavia and the Albanian Communist Party. Although Hoxha instituted a government system based on orthodox Marxist ideology and Stalinist practices, postwar Yugoslav patronage countered the prewar Italian influence, and the alliance between Tito and Enver Hoxha continued through the 1940s. By the end of the 1940s, however, relations between Hoxha and Tito had disintegrated, and Albania had forged an affiliation with the U.S.S.R. The Albanian-Soviet relationship, in turn, suffered increased tensions in the late 1950s when Soviet leader Nikita Khrushchev departed from a strict Stalinist ideology. In the early 1960s tensions between the Soviet and Albanian regimes temporarily declined. Subsequently, however, the Albanian regime broke diplomatic relations with Moscow because of Soviet interference in domestic politics and began siding with the Chinese in the Sino-Soviet dispute.

In return for their industrial and technological assistance to Albania during the 1960s and 1970s, the Chinese gained a sphere of influence in Central and Eastern Europe. After the death of Chairman Mao Ze-dong in 1976, Hoxha accused the Beijing leadership of revisionist leanings, which led to a series of conflicts between China and Albania. The final dispute arose from China's overtures toward the United States and Yugoslavia; diplomatic relations between Albania and China were severed in 1978.

During the years of Soviet-Albanian and Sino-Albanian alliances, the Hoxha government received economic assistance and investments from its allies, although most of the foreign equipment was antiquated even then. After the demise of the Yugoslav, Soviet, and Chinese alliances, Albania's isolation from both East and West exacerbated its stagnation and poverty. From the end of the Sino-Albanian alliance, Enver Hoxha

became increasingly autocratic, asserting extreme isolationist policies and stressing national self-reliance. For example, hundreds of thousands of small concrete bunkers were built, particularly along foreign borders and the coast, at a cost the country could ill afford. A clause was added to the constitution prohibiting Albania from "seeking foreign aid and credits or forming joint companies with foreigners." The 1976 constitution formally abolished private ownership of property and prohibited practice of any religion, giving force to a 1967 act and making Albania the first officially atheist state in the world. Simultaneously, Hoxha's secret police, the Sigurimi, liquidated all manifestations of dissent and political opposition.

Until his death on April 11, 1985, Enver Hoxha exerted strict control over domestic economics and politics, while internationally the country remained totally isolated. Ramiz Alia, Hoxha's hand-picked successor, initially continued the dictator's xenophobic policies. But by the late 1980s Albania's economic condition had deteriorated to the point that President Alia was forced to make some modest attempts at economic liberalization. Partially abandoning the doctrine of self-reliance, he reestablished political and economic relations with several Western countries, including Austria, the Federal Republic of Germany, and Italy.

Economic and Political Revolution

The refugee crises in the summer of 1990, when thousands of young Albanians clamored for escape to Italy and Greece, exposed Albania's internal problems to the international community. Meanwhile, Albania sought admission to the Conference on Security and Cooperation in Europe but was rejected because of concerns over human rights violations.

In Eastern Europe as a whole, the winds of change had become irresistible. In December 1990 student and labor strikes put significant pressure on the Alia government for multiparty elections, and on December 19, 1990, the first opposition party, the Democratic Party of Albania, was officially registered.

The collapse of the old regime in Albania is attributable to the steady economic decline over the years, which was fueled by the government's political and social repression of large segments of the population. Although the Alia regime allowed greater independence to enterprise managers, sufficient incentives for increasing production were not provided, and the price system remained unchanged. In the late 1980s the government allowed importation of some consumer goods in an attempt to satisfy rising public demand. Meanwhile, transfers from state enterprises to the budget decreased, yet employment increased as a result of the continuing expansion of the working-age population. Halfhearted relaxation of economic controls without real structural reforms led to significant macroeconomic deterioration.

In early 1991 production began to collapse in both agriculture and industry. The first multiparty elections since Fan Noli's time were held on March 31, 1991, and although the ruling Albanian Workers Party manipulated the elections, the opposition Democratic Party of Albania enjoyed wide support in the main cities. Despite its success in urban areas, the opposition did not gain sufficient seats in the parliament to form a government. Prime Minister Fatos Nano was again given the governmental mandate by President Alia, but his government fell in May 1991 following extensive labor strikes. Ylli Bufi was asked to form a multiparty caretaker government, and the opposition decided to join his endeavor.

During the same period, the Albanian Workers Party (the name adopted by the Communist Party in the 1960s) followed the lead of other Communist parties in the region and changed its name to the Albanian Socialist Party. Meanwhile, the opposition Democratic Party began to push for economic and political reforms. Under the Democrats, who had support in the People's Assembly and control of the Ministry of Finance and the Ministry of the Economy, privatization of agricultural cooperatives began, although in a disorderly manner; private business activities were legalized; and price controls were partially removed. As was true of previous attempts at economic reform, there was no coherent and decisive reform strategy,

and the piecemeal reforms led the country into even greater economic instability. Production, according to official figures, fell 24 percent in the agricultural sector and 37 percent in the industrial sector, although these figures should be taken as only rough estimates, given the weakness of the data-gathering and -reporting system.

In an effort to force early elections, the Democratic Party, led by Dr. Sali Berisha, withdrew from the government in December 1991. A caretaker government under Prime Minister Vilson Ahmeti came to power as the economy entered a period of even greater crisis marked by mass destruction of state-owned property, including schools, transport and electrical systems, food distribution warehouses, and hospitals. Popular manifestations of frustration over the political situation and the absence of consumer goods gave rise to an increase in street crime, which had been almost unknown under the Communist regime.

Against this backdrop, early elections were scheduled for March 22, 1992. The opposition, primarily the Democratic Party, had garnered a large number of supporters throughout the country in the year since the last elections and had focused its campaign messages on Albania's integration into Europe. The Democratic Party successfully blamed the Communist regimes for social and economic collapse. At the same time, fear of retribution against those supporting the Democratic Party had diminished. The average voter believed that economic conditions could only improve under a new political leadership. On election day, the opposition carried almost two-thirds of the vote nationwide and subsequently established a government with the strongest mandate for complete socioeconomic transformation in post-Communist Eastern Europe.

In April 1992 the parliament elected as president Dr. Sali Berisha, a cardiologist-turned-politician and the chairman of the Democratic Party. Prime Minister Aleksander Meksi formed a government composed of leading pro-democratic politicians and nonpolitical intellectuals. The new government immediately launched ambitious political and economic reform programs. The basic goals of the economic reform mea-

President Berisha on Albania's Economic Program

"We decided to stick to the IMF [International Monetary Fund] program in a very difficult situation, and we respected all its items. We are making huge sacrifices, but at the same time we are demonstrating that freedom is working. Graduality seems at first sight to be the "social" approach. But it could have been a prolonged agony, and that is the reason that I pay tribute to shock therapy. Hard decisions are necessary for difficult situations. Graduality, to me, is a slow, painful agony. Shock therapy is a real electric shock. I use medical terms, but you could also say that it is an earthquake where you get better sooner."

Interview with the Central European Monthly, July 1993



"Many friends of ours speak of the Albanian miracle, but this is not the case. Albania is still the poorest country in Europe and will remain as such for a given time. What these friends call the Albanian miracle is the fact that the economic reforms saved Albania from falling down into the abyss of history, wherein it was going before March 22, 1992."

Speech to the Albanian Democratic Party Congress, December 1993

asures were to stop the emerging hyperinflation, reestablish control over the budget, privatize agriculture, and mobilize foreign economic support.

The World Bank in Albania

The Bretton Woods institutions—the World Bank and the International Monetary Fund (IMF)—and Albania entered into a working relationship only in 1991, when Albania sought membership in these international financial institutions. For more than three decades the Hoxha regime had avoided any contact with multilateral organizations, which the regime had branded imperialist agencies. Things finally changed in late 1990, as the Alia government felt the pressure of events elsewhere in Eastern Europe and as Albanians themselves forced the regime to liberalize and retreat from the intransigent iso-



President Sali Berisha (right) with Kemal Derviş of the World Bank on a mountain road near Vlorë, July 1992

lation of the past. The Republic of Albania became a member of the World Bank on October 15, 1991.

A new, much more active phase of cooperation between the World Bank and Albania began when elections were announced for March 22, 1992. The opposition had pulled out of the coalition government, and the country was in a desperate situation, with production collapsing, law and order breaking down, many Albanians trying to flee the country, and inflation accelerating to more than 500 percent on an annual basis in the last two months of 1991.

The World Bank's management saw the spring elections as a much-needed opportunity to stop the slide into economic chaos and provide support through a rehabilitation program. In early January 1992 Kemal Derviş director of the Bank's Central Europe Department, made an initial management visit to Albania, accompanied by Huda Kraske, the Bank's first country officer for Albania. They insisted on meeting the leaders

and representatives of all political parties contending in the upcoming elections. In these meetings the World Bank offered prospects for strong, rapid financial and technical support for a rigorous and comprehensive reform program immediately following the elections. The World Bank explained that if such a program were to receive broad international support and benefit from the best possible technical advice, it would need to be supported by an arrangement with the IMF. IMF staff, for their part, started preparing the ground for such a program with two visits in January and February 1992. Basic data were gathered, and consultations started with other donors, notably the European Community (now the European Union).

With the sweeping victory of Dr. Berisha's Democratic Party in the spring elections and the installation of the first non-Communist government, under Prime Minister Meksi, in April 1992, a new phase opened for Albania and for its cooperation with the Bretton Woods institutions. The preparatory work done in January and February proved decisive; plans for a stabilization program with the IMF and a Critical Imports Project with the Bank were ready the very day the new government took office. Negotiations with both the Bank and the Fund were successfully completed in May and June, and the \$41 million Critical Imports Project was presented to the Bank's Board on June 25, 1992, only eight weeks after the formation of the new government.² Albania became eligible for credits from the International Development Association (IDA), which are available on more concessional terms than standard World Bank loans or loans from commercial banks.

In July, along with the implementation of the Critical Imports Project, which was targeted at supply responses in agriculture, power, and transport, Albania launched a "shock therapy" macroeconomic stabilization program agreed with and supported by the IMF. Only days after the signing of the letter of intent, an aid coordination meeting led by the European Union convened in Tiranë to broaden international financial support and harmonize the efforts of the various donors. On August 1, 1992, the World Bank opened a Resident Mission in Tiranë.

Implementing World Bank Projects

The World Bank has standard procurement rules, such as international competitive bidding, limited international bidding, and international or local shopping, so that enterprises from all member countries can participate in the bidding, with attention to economy and efficiency. These rules apply to all borrower countries. They are, however, not always well understood, they are not easy to enforce, and they can lead to many problems in project implementation. To ensure that all goods procured for the government on the international market meet international criteria and are bought in a way that allows competition, Project Implementation Units (PIUs) have been established within the Albanian government.

Implementation of the first World Bank projects has been coordinated through a PIU in the Ministry of Finance. That unit has been primarily preoccupied with implementation of the Critical Imports Project, Technical Assistance for Economic Reform, and the Agriculture Sector Adjustment Credit. Because of the wide scope of World Bank operations in Albania, PIUs have been set up in other ministries as well.

The vigor and results of Albania's version of shock therapy have been impressive. Almost all prices were immediately freed except for bread—the price of which was, however, increased fourfold—and some other staples. (Pensioners and some workers received financial compensation.) All quantity restrictions on imports were lifted, and the exchange rate was allowed to float. Tariffs were lowered to an average of 20 percent. The budget deficit was cut in half, Central Bank credits to enterprises were curtailed, and tight overall monetary targets were strictly enforced. An incomes policy linked public sector wages to enterprise performance. Most of agriculture was privatized before the end of 1992 and almost all housing by the end of 1993. The figures that follow summarize the macroeconomic results of this shock treatment.

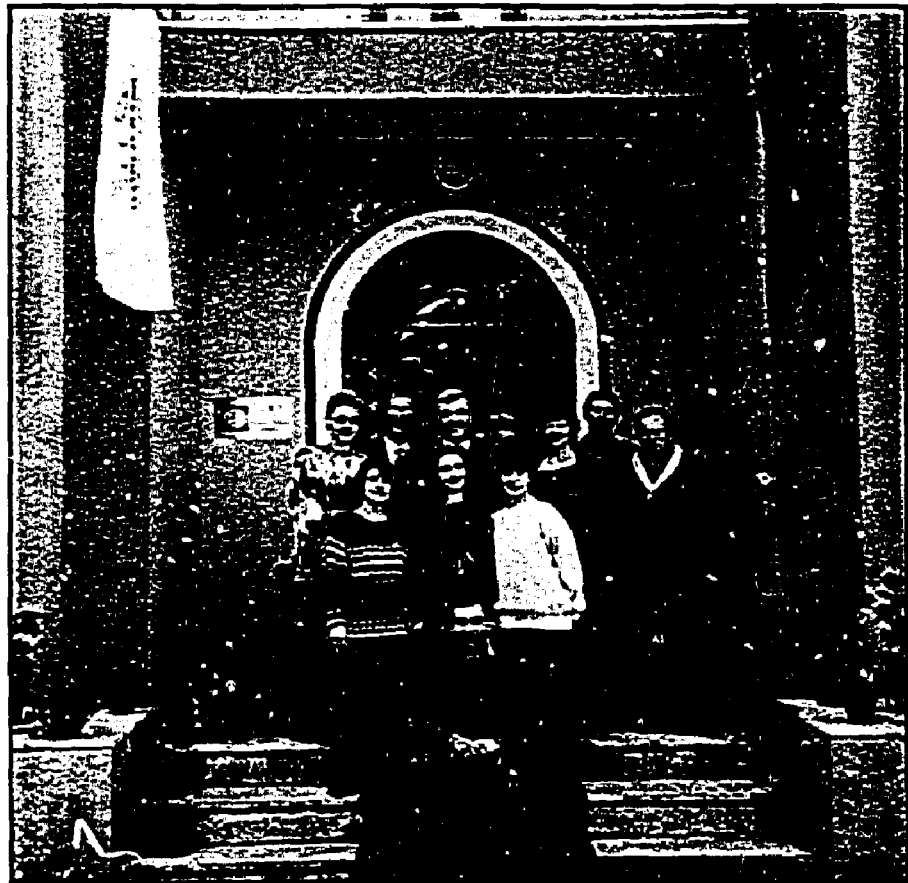
The initial success of the macroeconomic program does not mean that the rehabilitation and development of Albania, after years of oppression, isolation, and poverty, will be a quick and easy process. On the contrary, immense structural and institutional obstacles remain as the country tries to regain some of the ground it has lost over decades.

The World Bank's Resident Mission in Albania

“Our main duty is to create a ‘human link’ with the World Bank headquarters, to facilitate project preparation and implementation, and solve the bottlenecks encountered during these processes. Furthermore, we provide informal technical assistance to the Bank’s project implementation units, as well as hands-on policy advice to the government on request.

“Since all task managers cannot spend all of their time in Albania, our project officers and economist coordinate and oversee the various phases of the project process. With the large number of projects under preparation and implementation in Albania, the pace of our work can be exacting. At the same time, the work is particularly rewarding. The economic changes in Albania are happening at a brisk pace, and being on the cutting edge of policy and project decisions related to these changes provides unique challenges as well as rewards.”

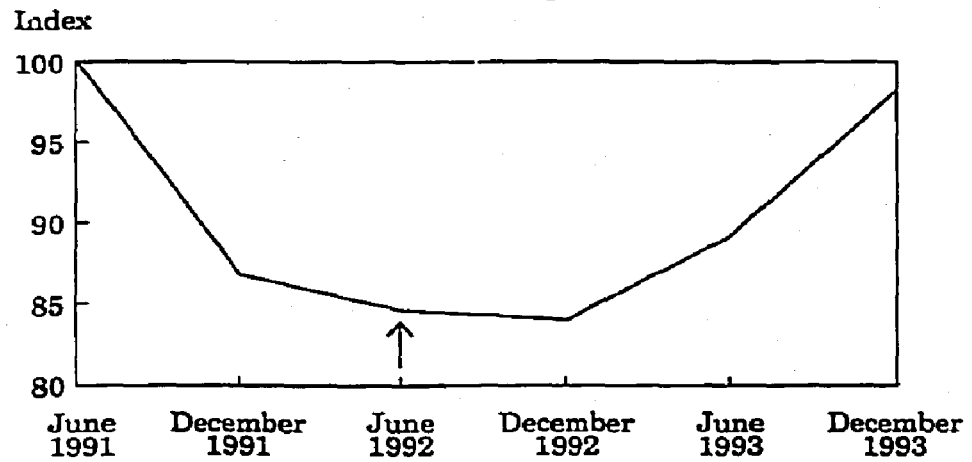
Kutlay Ebiri, World Bank Resident Representative in Albania



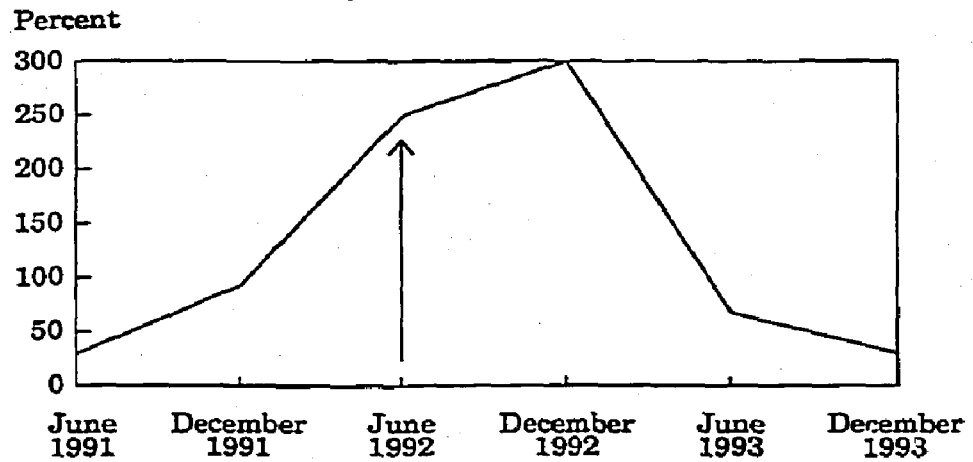
The staff of the World Bank's Resident Mission, Tirane

Macroeconomic Indicators, Albania, 1991-93

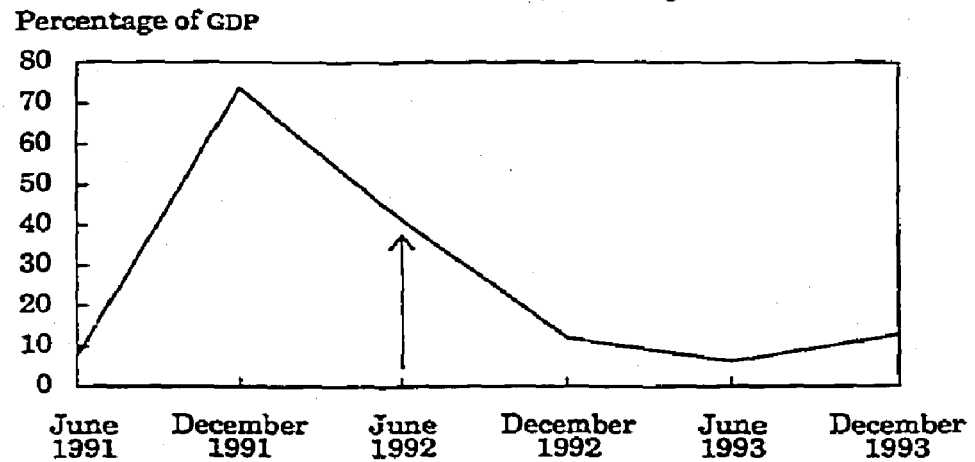
Gross domestic product



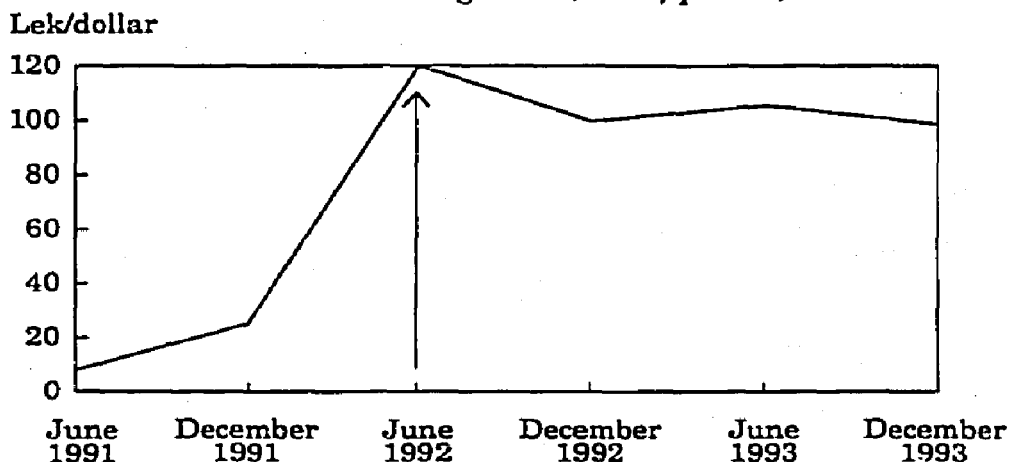
Inflation (annual basis)



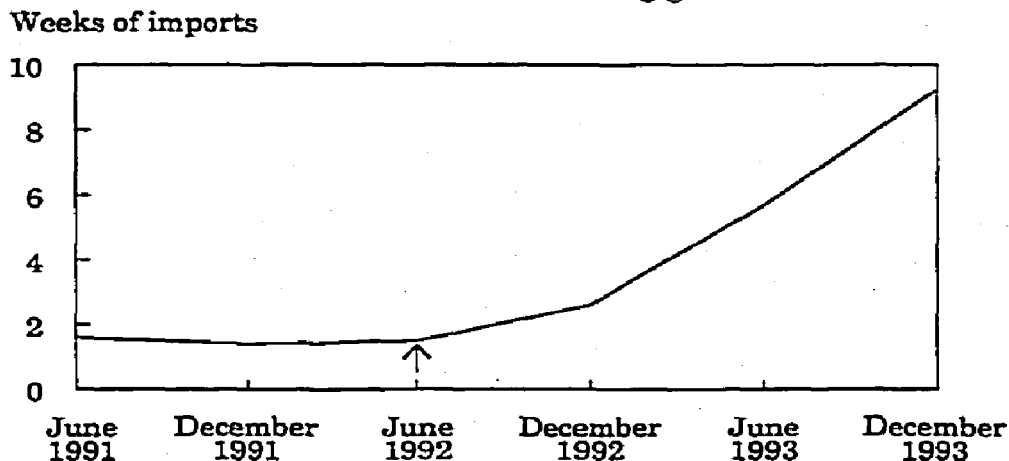
Domestic deficit financing



Market exchange rate (end of period)



Gross reserves (excluding gold)



↑ Start of adjustment program supported by the World Bank and the IMF.

Note: Data are semiannual.

Source: Albanian national data; World Bank and IMF staff estimates.

The vigorous output growth that followed on the heels of decisive victory over the hyperinflation which had been developing in early 1992 demonstrated that a tough macroeconomic program does not condemn a formerly Communist country to stagnation. On the contrary, it may actually be a condition for new growth. But can this success be sustained? Can macroeconomic stability endure despite the pent-up frustration of a population that has gone through terrible suffering and now

expects rapid improvements in real income? Can a country located in a region threatened by ethnic tensions, with three religions and with a history of violent repression, emerge as a small haven of peace and economic growth? How can privatization be successful outside agriculture and services? Can a new public administration that is adapted to a market economy emerge?

In 1993 Albania benefited from a substantial inflow of foreign aid. How can sufficient foreign resources be mobilized for a few more years to consolidate the recovery? Can the World Bank help design and, what is more difficult, implement a work program that contributes to the continuation of this initial success?

Only the future will show whether Albania can overcome its difficulties and achieve prosperity and peace for its people. At the invitation of Albania's leadership, the World Bank Group has decided to extend its full support to Albania's development effort, within IDA's tight resource constraints.

The men and women of the World Bank, working with their Albanian counterparts, have launched a broadly based effort that reaches out into many sectors to help build a new modern Albanian economy. This booklet describes these joint efforts. In it, some of the people who are leading this work explain their hopes and visions, going beyond the often subdued and perforce technical language of official documents. Their words reflect much effort, great concern, and immense hope for Albania's future.

Notes

1. The World Bank Group consists of the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA), together referred to as the World Bank, and their affiliates, the International Finance Corporation (IFC), the International Centre for Settlement of Investment Disputes (ICSID), and the Multilateral Investment Guarantee Agency (MIGA). The World Bank's central purpose is to help raise standards of living in developing countries by channeling financial resources from industrial countries to the developing world.

2. All dollar amounts are current U.S. dollars.



INVESTMENT IN INFRASTRUCTURE

As a consequence of failure to invest enough in maintenance or new construction after the mid-1970s, Albania's infrastructure is not adequate to support a modern society and a market economy. The situation, although not entirely unlike the predicaments of other Central and East European countries, is more difficult because the period of total stagnation in the 1980s and the transition crisis during 1990-92 were worse than elsewhere. Albanian wages are comparatively low and the work force is relatively skilled, which should make the country attractive to foreign investors. The pristine mountains and expansive Adriatic beaches make Albania potentially an ideal tourist destination. But the lack of adequate infrastructure is hindering foreign investment in both industry and tourism.

Albania did receive some technology, investments, and foreign aid from the U.S.S.R. during the period 1950-61 and from the People's Republic of China between 1961 and 1978. Most of the hydropower plants were constructed by the Chinese. Unfortunately, the technology was generally mediocre in quality, low in efficiency, and targeted largely at agriculture and industry. By the beginning of the 1990s even the newest structures were in a desperate state of disrepair.

During the years of total isolation, the scarce resources were targeted toward industry and agriculture in an effort to attain self-sufficiency at any cost. Today, few examples of modern buildings can be found. Among the notable exceptions are two that are indicative of the emphasis on the Communist Party during that era and the attempt to create a new Communist "culture": a museum built to honor former dictator Enver Hoxha, and the Palace of (Communist Party) Congresses. These buildings, as well as a museum honoring the national hero Skanderbeg, were constructed at great expense, with central heating, air conditioning systems, and other luxuries unknown to most Albanians.

With the political and social turmoil in 1991-92, the infrastructure, particularly schools and distribution systems for electricity and water, was further battered by misuse and malicious destruction. Following the March 1992 elections, the new government drew up plans to rehabilitate existing roads, housing stocks, and water and electricity distribution centers while assessing possible new investments.

The first World Bank operation in Albania, the Critical Imports Project, financed modern parts and equipment to restore roads, ports, and other infrastructure, mend local irrigation systems, repair hydropower stations and electricity transmission and distribution systems, and promote agricultural production. The objective was to support the development of economic activity, particularly in agriculture, by enhancing the ability of the new smallholders to produce agricultural goods and distribute them to nearby markets.

The need for rehabilitation and new investments far exceeds financing possibilities. To provide strategic plans for and finance of rehabilitation and new investments, the Albanian government, with the assistance of the World Bank, has developed a three-year Public Investment Program. This program, which is to be updated each year, encompasses all sectors of the Albanian economy and attempts to provide a sector-by-sector overview of where new investments will be made or existing structures will be rehabilitated.

The World Bank has completed a number of studies on infrastructure, assisted with the formulation of strategies, and financed investment projects in certain infrastructure subsectors. At the same time as the World Bank is emphasizing rehabilitation of existing structures, the Albanian government is seeking additional financing from other sources and is using funds from the state budget to finance new infrastructure.

Transport

The entire Albanian transport system needs rejuvenation. Adequate roads, ports, and international airport facilities are prerequisites for developing a domestic market economy, encouraging foreign investment, and promoting tourism. Improved transport services will be important for the transition from central planning to a market-driven economy.

Acknowledging the deficiencies in the sector, the government has established several priorities, including restoration of the limited road system, modernization of Durrës Port and Rinas (Tiranë) Airport, and, ultimately, construction of new roads and highways. The World Bank is supporting these priorities through the Transport Project. Cofinancing from external sources has been mobilized by the Bank. In addition, World Bank projects in agriculture are targeting improvements in rural transport.

Roads

Until 1991 ownership of private vehicles was prohibited. After the ban was lifted, the number of automobiles rose, by more than one-third between 1991 and 1992 alone. Initially, a serious policy mistake was made by allowing vehicle importation with virtually no tariff payments. This was corrected, and beginning in early 1993 a minimum tariff of \$400 per vehicle was levied, bringing revenue to the state budget from a segment of the population that can afford to pay. In 1994 the rate was increased to \$500 per vehicle. The road network requires

Rehabilitating Transport

Through an \$18 million transport project, approved in May 1993, the World Bank is financing the rehabilitation of about 80 kilometers of main roads, as well as repairs to the port of Durrës, and will provide technical assistance for the implementation of a transport policy.

To facilitate the marketing of agricultural production and to provide services and employment to the poorest segment of the Albanian population, the World Bank is preparing another project that will finance the construction of 1,500 kilometers of rural feeder roads.



“Preparing the first set of bidding documents was not easy. After all, nobody in Albania had the slightest experience in international competitive bidding or World Bank procedures. The Ministry of Transport would, of course, like to be as ambitious as possible, because the needs are immense. On the other hand, budgetary resources are extremely tight, and inflation must be kept under control. The challenge for all of us, Albanians and World Bankers working on transport, is to choose the most urgent priorities and to implement effectively at the lowest possible cost. It will be an ongoing struggle.”

Luis Revuelta, task manager, First Transport Project

rapid strengthening to support the increased number of vehicles. Some major roads still in use today were built by the Austrians, Germans, and Italians during World War II; however, few repairs were undertaken after completion.

Albania has a road network of 18,000 kilometers—2,900 kilometers of paved and 4,900 kilometers of unpaved roads administered by the central government and 10,200 kilometers of minor roads managed by local governments. Repairs are being made on almost half of these roads. About 400 villages, with a combined population of 1 million—nearly one-third of the total population—are inaccessible to motor vehicles for at least part of the year. With the World Bank’s support, the government plans to improve feeder roads to these remote villages to facilitate transport of goods to market and provision of services.

Some progress in private sector development is already apparent. Newly privatized enterprises are providing intercity bus connections and trucking services. Road repair and construction are being carried out on a commercial basis by state-owned enterprises and joint ventures. Encouraging the private sector is a priority for the government and is proving to be an important element of revitalizing transport services.

Seaports

The disruption of transport lines through the former Yugoslavia, coupled with the inadequacy of the road system, necessitates greater reliance on seaports, which afford the most significant access for both imports and exports. Albania has four operational ports: Durrës, Vlorë, Sarandë, and Shengjin.

Durrës, Albania's second largest city, was in Roman times the most important port on the eastern shore of the Adriatic; there, people and merchandise began their eastward trip to the Orient. Today Durrës handles approximately 85 percent of Albania's port traffic. Yet, as Zafer Ypi, director of the Port of Durrës, points out, "the port facilities are in desperate need of improvement." New equipment, berths, storage facilities, and training for workers are needed. Although exports through Albania's ports have dropped as a consequence of the decline in output from 1990 to 1992, overall shipping at Durrës has increased owing to the large amount of imports and aid deliveries and the use of port facilities by neighboring countries.

Under the World Bank Transport Project and with cofinancing from a Kuwaiti government fund, the port authority is improving the facilities. At present, few cranes for loading and unloading cargo are operational, storage facilities are limited, and no ferry terminal exists. Since grain imports are expected to continue at high levels over the next decade, silos and other storage facilities must be constructed. When financing is available, a ferry terminal will be constructed to provide greater tourist access to the country.

"It Is Not Easy to Adjust. . ."

"We lived in a socialist system for years, and it is not easy to adjust quickly to free market conditions. Therefore the World Bank project is very valuable for us since it will help us improve our technical and administrative capabilities to handle the increasing traffic at the Durrës port. Other parts of the project will help supply the basic handling equipment, containers and storage facilities, [which] is important because Durrës is and will be a very important port in the Balkans.

"All these efforts will, of course, require us to change our mentality, work very hard, and increase not only the quantity but also the quality of port services. In this respect, the World Bank is also helping us to develop a master plan that will put our long-term efforts into perspective and help us effectively design the future development of the port of Durrës."

Zafer Ypi, director, Port of Durrës

Improvements financed with funds raised by the port authority and from external sources (including the World Bank Transport Project) will make it possible for Durrës to handle at least 3 million megatons of bulk cargo and 1.4 million megatons of general cargo per year, enabling the port to fulfill Albania's needs through 2000.

Vlorë, the second largest port, is the primary fishing port and handles oil exports. Whereas funds for modernizing the Durrës port will be raised through the autonomous port authority, any improvements at Vlorë will be financed privately, either by the emerging private fishing industry or by private oil companies. Under the previous government, plans were under way to build a new facility a few miles from the existing ones. In view of current budgetary constraints and privatization efforts, funds to complete the Vlorë port should now be raised through the private industries that use this facility.

Civil Aviation

Tiranë's Rinas Airport was constructed to accommodate minimal passenger traffic. But the number of flights has increased from about two a day in 1990 to nine or ten flights a day in 1993, and the number of passengers from 50,000 to 130,000 a year. As the only civil aviation facility in the country, the airport must be upgraded to provide adequate services to passengers. As a start, the air terminal has been updated to better process the increased traffic. Meanwhile, plans for strengthening the runway, installing runway lighting and navigation equipment, and making more extensive improvements in the terminal, apron, and taxiway facilities are being assessed. Future investment plans in civil aviation include opening up the ten military airports for internal civil aviation operations.

Says Ferdinand Petrela, director of Albtransport, a joint-venture civil aviation agency, "We need to reconstruct the [Rinas] airport to improve the services and tackle this dramatic increase in traffic. . . . As a result, we prepared tenders and accepted an offer for reconstruction, which is scheduled to begin as early as March 1994."

Railroads

The Albanian railway system, operated by the Ministry of Transport and Communications, receives large operating subsidies from the state budget. Railroads had been a major means of passenger and industrial transport, but in February 1992 passenger services were closed because of safety concerns stemming from the breakdown of public order. Subsequently, with the collapse of state enterprises, rail transport was not required for industrial goods, either. For almost eighteen months the railways remained closed; there were not enough goods to be transported and the increase in private vehicles cut into demand for passenger transport. The government is assessing various strategies for the future of both industrial

and personal rail services. Plans to link Albanian railways with those in the Former Yugoslav Republic of Macedonia (FYR Macedonia) and in Greece have been postponed pending evaluation of the possibilities for cost recovery.

Other Transport Challenges

Currently, the governments of Bulgaria, FYR Macedonia, Turkey, and Albania are assessing the possibilities for strengthening east-west transport links. Albanian ports would serve as the Adriatic outlet for goods from these countries. Although the project is long term, Albania will start work on some segments of a new "Via Ignatia" in 1994. (The Via Ignatia was famous in Roman times as the most direct link between Rome and Byzantium.) Once the road is completed, the traveling time from the border of FYR Macedonia to Durrës port could be only a couple of hours, against more than four hours on the unimproved roads.

During 1993 the Albanian government focused on rehabilitation of roads, ports, and the international airport while moving cautiously on new investments throughout the transport sector. Particular attention is being given to the cost of maintenance of both improvements and new investments. Extensive road and airport rehabilitations are planned for 1994.

Water, Sanitation, and Energy

Development of water, sewerage, and energy services for homes and industries will improve living conditions, encourage private sector development, and facilitate direct foreign investment. Among the significant accomplishments of the Communist years was that many urban homes and all industries were connected to water, sewerage, and electricity centers operated by district governments. About 95 percent of rural villages are connected to local water and electricity supplies.

Albania has the potential to become a significant exporter of electricity and has abundant underground and surface water

supplies. The challenge is to ensure that these assets are used efficiently by households, agriculture, and industries. In their consultations with the government, World Bank staff have recommended that decisions on investment in the water, sewerage, and energy sectors take into account the potential for recovering investment costs and that explicit budgetary subsi-

Bringing Water to People

To improve water services in Albania's second largest city, the World Bank and the Albanian government formulated the Durrës Water Supply Project. Says Richard MacEwen, the task manager for the project, "The Durrës Water Supply Project will restore 24-hour service to existing water consumers in Durrës and surrounding communities which now only have water an average of four hours each day. The project will accomplish this through rehabilitation of existing pipes without undertaking major investments in production capacity." Current losses through leakage are estimated at 50 percent, and if production capacity were increased without rehabilitation, leakage would approach 75 percent of production. The project also includes critical repairs to sewerage systems in Durrës district and technical assistance to strengthen the management of organizations in the district responsible for providing water supply and sewerage services. It will benefit about 200,000 citizens in the area.



Local officials preparing the Durrës Water Supply Project

dies be targeted only to the poorest regions or segments of the population.

The great public demand for water and electricity makes it difficult for these antiquated systems to keep up. Leaks in water pipes are causing contamination, sewage is being discharged without benefit of treatment, and electrical equipment is significantly damaged as a result of the overloading of distribution systems. Existing water and electricity distribution facilities require repairs to undo the intentional damage incurred during the revolution and the general lack of maintenance in previous years.

Water and Sanitation

Despite its plentiful water supplies, Albania is having to develop strategies for supplying sufficient drinking water to its population. For most households, water is available only three to four hours in the day because of leaks in poorly maintained distribution networks and mass water storage by industrial enterprises. Inadequate water supply, chlorination facilities, and sewerage service, especially in urban areas, are a risk to public health, an impediment to economic growth, and a source of great hardship for the population.

The central objective of the government in the water and sanitation sector is to ensure that the country's limited resources are used in the most efficient manner. The World Bank is providing assistance to the government under the Durrës Water Supply Project, which is designed to eliminate water shortages, improve management, and repair sewerage collection systems through rehabilitation of facilities in the district of Durrës.

Energy

The autonomous agency for electricity distribution has carried out repairs to the distribution network and is installing new meters to replace those damaged during the revolution. Albania's electricity distribution and transmission networks are

badly overloaded as a result of quadrupled consumption by households and a significant increase in the use of electricity by newly established small commercial entities since 1989. The entire power system urgently needs to be strengthened.

Richard Hamilton, the World Bank's task manager for the Power Loss Reduction Project, says, "The cost of rehabilitation and reinforcement in electricity will be high, and paying for it will require eliminating the widespread unbilled use of electricity and greatly increasing electricity prices." The World Bank team has been working closely with the Ministry of Mineral Resources and Energy and the Albanian Electricity Corporation (KESH) to help the government define a strategy for the energy sector. Under the Critical Imports Project, the World Bank financed urgent repairs to hydropower stations and electricity transmission and distribution networks. The Power Loss Reduction Project, under preparation by the government and the Bank, will provide KESH with financing for an action plan that will reduce the unbilled consumption of electricity. A project under consideration would support the rehabilitation, upgrading, and expansion of the transmission and distribution networks.

Albania was a net exporter of oil until 1989, but then production fell by about 50 percent. The government is actively exploring ways to increase oil and gas production to the earlier levels. At the request of the government, the Bank has provided experts to advise on ways of encouraging private participation in the sector while ensuring that the rents from Albania's oil resources benefit the country. Large international oil companies are considering offshore and onshore exploration in Albania, as well as enhanced oil recovery agreements. Such investments would bring about a significant increase in oil production.

Energy sector reforms are important on at least two counts. First, for the macroeconomic health of the country, implicit and explicit subsidies should be reduced to ensure rational pricing and efficient allocation of resources. Second, increasing the supply of electricity for heating and other household uses could help stem or reverse environmental degradation caused

“ . . . the Housing Sector Must Be Privatized ”

“When we took office, we defined our new policy [in housing] in two dimensions. Economically, we decided that the housing sector must be privatized. We prepared the environment for every Albanian to be able to buy and sell building materials, build houses, and sell them at market prices. Socially, the government decided to assist those people who are not capable of buying houses in the market, particularly about 10,000 ex-prisoner families, about 10,000 families who had to leave their houses as a result of restitution, and those with incomes below the minimum living standards.”

*Adem Duka, general director of housing,
Ministry of Construction, Housing and Territory Adjustment*

by random cutting of trees for fuelwood. To assist the government with strategies for dealing with the energy sector, the World Bank has financed an Energy Sector Study. Projects based on the findings of the study are in preparation and, with cofinancing from other sources, may help Albania develop its considerable energy resources in the most effective way.

Housing

Albanian housing standards are low compared with those in other countries of Eastern Europe, and dwellings are typically overcrowded, often with three or four generations residing in a small flat. An estimated one-third of the country's 675,000 dwellings have no piped water. There is virtually no central heating in the flats, and practically no maintenance on state-owned housing has been undertaken since construction.

Although some citizens, particularly in rural areas, were allowed to retain their homes during the Communist regime, more than 70 percent of urban housing was expropriated by the state. The government put all public housing on sale to occupants in the spring of 1993. Prices were kept low—approximately \$100–\$150 for a small flat—and a choice of payment plans encouraged a large number of tenants to purchase their apartments. Revenues from apartment sales are earmarked for use by the National Housing Agency to finance the comple-

tion of unfinished flats, which are then sold to private households or local authorities.

To alleviate the housing shortage and improve the quality of the remaining stock, the government intends to enlarge the role of the private sector. Policies have been designed to encourage the development of a private housing market through privatization of state-owned housing, the development of a real estate market, and improvement of auxiliary infrastructure such as electricity, heating, and water distribution. The state-owned housing stock, reserved for those who cannot afford to purchase their flats, is also being improved.

Telecommunications

Telecommunications access—a luxury not available to many citizens during the previous regime—is important for market development and improved living standards. As part of a general strategy for expanding telecommunications, operational control of telecommunications has been transferred to Albania Telecom. Although there are no immediate plans to privatize telecommunications, Albania Telecom is seeking joint venture partners to provide funding for updating the system.

In 1992 there were only 46,000 telephone connections in Albania (1.4 connections per 100 persons), and there was a waiting list of 30,000 households. Most telephone calls are manually connected. Microwave transmission is used between Tiranë, Shkodër, Gjirokastër, and Korce, and there are international radio connections with Greece and Italy.

The World Bank has provided some technical assistance in telecommunications but has left financing of the sector to the European Bank for Reconstruction and Development (EBRD). The first EBRD-supported telecommunications project is now being implemented.



Albania is changing very quickly. New roads, improved electricity and water service, and modern conveniences are visible to Albanians and foreigners alike. The continued dedication of

Providing Living Space

"The relations between the Ministry and the World Bank have really been impressive. Without doubt, the contributions of all the World Bank employees have been extremely valuable. The Housing Project is going on very well, with 97 percent of total housing stock privatized and the establishment of the National Housing Agency. However, we perceive the achievements so far as too few compared to the overall needs of the housing sector in Albania. . . . In the future, we hope to find more funds to enable us to make new investments."

Ilir Manushi, minister of Housing, Construction and Territory Adjustment



In the summer of 1992, during a dinner attended by Albania's President Sali Berisha, Ilir Manushi, the minister responsible for housing, and Kemal Derviş of the World Bank, the subject of housing arose. Concerned about the large numbers of half-finished housing units and the resulting housing crunch, President Berisha told Kemal Derviş that completion of the 13,000 dwelling units under construction was an overriding priority for the government and that privatization of publicly owned flats was also urgent. The eventual outcome of the conversation was the World Bank Housing Project.

Design and implementation of the project were the responsibility of Minister Manushi and his team. Task manager Gian Carlo Guarda from the Bank's Infrastructure Operations Division was responsible for putting together the project on the World Bank side. He sought and obtained substantial professional support from the Office of Housing and Urban Programs of the U.S. Agency for International Development.

Ultimately the project had three components. First, because a private housing market was a priority, the government concentrated on selling existing rental units to residents. Second, at the same time, the World Bank financed the completion of public housing units, the construction of which had been interrupted because of lack of funds. These units are being privatized immediately after completion of the work. The third part of the project, financed by a USAID grant, provides technical assistance to the National Housing Agency for the implementation of the project and for strengthening its institutional capacity.



"I was amazed at the speed of housing privatization, which began in May 1993 and was 97 percent complete by November. Minister Manushi's prediction was correct, and in six months most Albanians owned their flats. Now we are seeing the beginnings of a private real estate market. . . . Maybe because of the Albanians' spirit of entrepreneurship or possibly because of fear over inflation, Albanians were willing to invest savings in their residences."

Gian Carlo Guarda, World Bank



Residential buildings being completed under the World Bank Housing Project

Albanian authorities to improving infrastructure will encourage the development of a modern market-oriented society by providing improved living conditions for the Albanian population and making the country more attractive to foreign investors. Together, the government's dedication and the support of the World Bank have contributed dramatic improvements to one of the country's most important sectors.



AGRICULTURE

Traditionally, the foundation of the Albanian economy has been agriculture. Since 1990 farming and livestock production have been in a deep depression, but basic restructuring has now put them on a path toward recovery. The Albanian revolution was an arduous two-year process that saw state farms and agricultural cooperatives break apart, initially because workers refused to till the land and later through privatization. The process was exacerbated by the disintegration of agricultural infrastructure and distribution networks.

The total collapse of the old system offered a window of opportunity to begin reviving the most important sector of the economy. The new government assessed ways of restructuring the sector to promote the development of a market economy for agricultural products. Building on the initial privatization of agricultural cooperatives, which began in the summer of 1991, the first steps were to liberalize the prices of most foods (except bread) and to allow local farmers to compete with food aid being sold in the market. In late 1992 the government adopted a medium-term reform program designed to promote agricultural growth and development. Both the World Bank and the European Union assisted the government in preparing this program, which was published as a World Bank report entitled *An Agricultural Strategy for Albania*.

*Agriculture under Communism:
The Legacy of Ultracentralization*

Under communism, Marxist ideology ruled agriculture. All land was state owned or was clustered into state-dominated agricultural cooperatives. The 250 state farms, most of them located in the coastal plains, occupied 25 percent of the arable land and employed a work force of approximately 150,000. They accounted for 30 percent of total production and for a much greater share of the marketed surplus.

Marketing of inputs and outputs was fully controlled by the state, and prices and subsidies were set with no relation to costs. No freedom of labor movement, either within the rural areas or between rural and urban areas, was permitted. The country was self-sufficient in agriculture, but at a high cost that eventually became unbearable for the economy and contributed to the collapse of the economic system at the end of the 1980s. The final breakdown of agricultural production and markets was followed in 1990 and 1991 by considerable destruction of buildings and equipment in rural areas.

Today the entire state-owned agricultural marketing and processing sector is in a distressed situation. With factories working at 5 to 20 percent of their 1989 capacity, operations are highly inefficient, incurring large losses and debts. The declines in output and the increasing subsistence orientation of farmers have cut deliveries to agroprocessing enterprises. In 1992 only 5 percent of private farmers delivered part of their wheat to the *grumbullimi*—purchasing centers coupled with large milling and storage facilities—because most production was kept for household use.

The tentative reform efforts made during the 1980s in the other countries of Central and Eastern Europe and the former Soviet Union were much less evident in Albania. As a result, Albania faces the need for a very abrupt agrarian transition. A labor-to-land ratio that is unusually high for the region has created special problems for the design of the reform. Albania has about 1.4 hectares per worker (in Bulgaria the figure is 10.5 hectares). This means that not much agricultural land is available to support the rural population, but opportunities outside agriculture are also limited because of the undeveloped state of the rural economy. Thus workers who are displaced from agriculture to other sectors have great difficulties in finding gainful employment. Prospects will improve as new private activities develop throughout the economy.

"A Great Future"

"Agriculture is, of course, the most important sector of the Albanian economy, and restructuring is a great challenge. The results achieved so far are impressive, with full privatization of the land and an excellent recovery of production. I am very struck by the ingenuity of the Albanian farmers. There will be a great future in many areas of farming in Albania, and the farmers are clearly beginning to take advantage of that. . . . I am very optimistic about the success of our agriculture projects in Albania. Our projects will support the strengthening of private agriculture, improve infrastructure, sustain efficient pricing policy, and provide credit to farmers."

*Rory O'Sullivan, chief, Agriculture and Water Supply Operations Division,
Country Department II, Europe and Central Asia Regional Office, World Bank*



The Rural Poverty Alleviation Project will help improve village infrastructure. Here, residents of Lezhë meet to discuss their village's needs with the World Bank's Rory O'Sullivan.

Conscious of the importance of this sector to the Albanian economy, the World Bank has placed special emphasis on agriculture since the beginning of its operations in Albania. So far, results have been very encouraging, and Albanian farmers seem well placed to make good progress.

Although agriculture is the most important sector of Albania's economy, only 32 percent of the land (700,000 hectares, mostly in the coastal plain region) is arable. The most important field crops are wheat and maize, and as much as 60 percent of the farmland is equipped with irrigation facilities. About 410,000 additional hectares are used for pasture. Estimates indicate that two-thirds of Albanians live in the rural regions and that in 1990, when the revolution began, approximately half of the labor force was engaged in agriculture.

In the 1980s agriculture registered an average growth of 2.6 percent per year and accounted for approximately 35 percent of GDP. But between 1989 and 1991 output suddenly fell by 20 to 30 percent. Only the presence of large humanitarian programs—particularly Operation Pelican, a large food aid and distribution program sponsored by the Italian government—prevented widespread famine during the winter of 1991–92.

Even though Albania's transition began late, agriculture has progressed more quickly there than in most of the other reforming countries in the region. In 1993 agriculture accounted for 50 percent of the country's GDP, partly because of the collapse of the industrial sector. Agricultural production grew 18 percent in 1992 and close to 15 percent in 1993.

Given the depth of decline in the agriculture sector, the early successes are remarkable. But if progress is to be sustained, further reforms in land policy, infrastructure and services, and pricing policy will be required.

Land Policy

Land distribution has been the cornerstone for agricultural reform, and the early successes in agriculture have been based on the integration of the private sector into the production and distribution of farm products. As Albania moves into the second

phase of agricultural reform, the government must develop a systematic means of distributing land titles and a new legal framework for property rights, land sales, and land leasing.

Land distribution began in the summer of 1991 under the caretaker government of Prime Minister Ylli Bufi, with the apportionment of some agricultural cooperative holdings to private farmers. The process was disorganized, and some peasants, eager to obtain the best land at once, began staking plots of land without official sanction. Others reclaimed farmland expropriated from their families by the previous regime. With the installation of the reform program under the new government, the distribution process was reorganized, a preliminary land-titling system was introduced, and compensation of former landowners began.

Beginning in July 1992, the government transformed most state farmland into private holdings through land leases to employees. About 10 percent of former state farmland is being retained by the government to be managed by joint ventures with foreign companies or as state property to be reclassified as pastures. The leases were distributed on an egalitarian basis to entitled persons; the average area distributed per capita was between 0.2 and 0.3 hectares. The fixed assets and working capital of state farms are being sold, and sales revenues are being used to repay loans extended to state farms by the Bank for Agriculture and Development.

Progress in titling former agricultural cooperative holdings has been slow, as no local expertise in recording, displaying, and protecting property rights exists. Further confusion arose because of "land grabs" by peasants early in the privatization process. Lessons were learned, and titling has been more organized for state farms. As of December 1993, 81 percent of the former state farmland and 96 percent of former cooperative land had been distributed, mostly through issuance of a preliminary land title, or *tapi*.

On April 22, 1993, the parliament promulgated a law to compensate landowners who had received none or only part of the agricultural land that was in their possession before 1946. Previous owners of up to 1,000 hectares are to be compensated

with vouchers tradable for cash or at face value in future sales of state-owned enterprises. A former owner or heir who is entitled to a parcel of 15 hectares or less is to receive "full" compensation for that land. For parcels of between 15 and 1,000 hectares, owners and heirs receive compensation on a decreasing-scale basis. No prior owner or heir may receive full compensation on more than 46 hectares. The value of the vouchers is to be fixed by the Council of Ministers, and the district offices of the State Council of Compensation will implement the compensation scheme.

To avoid a chaotic and unregulated land market, the government has decided that sales of agricultural land in a given district will be allowed when the land registration system is in place and all claims for compensation by former owners have been resolved. As land registration systems are established and land title documents properly recorded, the government plans to sanction sales on an ever-widening basis, district by district, until transfers of agricultural land throughout the entire country are permitted.

An urgent need for Albania is the development of a legal framework for property rights. Leases, mortgages, and user rights must be defined by law in order to provide sufficient incentives for owners and users to improve their properties. The government is paving the way for land markets by drafting legislation for property rights and responsibilities, establishing a land distribution system, and developing a cadastre. These actions are supported through technical assistance components of the World Bank-financed Agriculture Sector Adjustment Credit.

Agricultural Infrastructure and Services

The greatest challenge to agricultural reform now is to create an environment that will encourage the newly emerging farmers to market their products and to specialize according to comparative advantage. This will require significant restructuring and rehabilitation of the agricultural infrastructure, including irrigation and drainage systems, agricultural equip-

ment, electricity supplies, and marketing provisions, as well as such agricultural services as credit, research facilities, and agricultural extension services. Although significant gains have already been recorded in agricultural rehabilitation, these challenges must be addressed to ensure long-term viability in the sector.

The World Bank has worked with the government on the problems of insufficient rural infrastructure and inadequate access by individual farmers to credits and other services. The Rural Poverty Alleviation Pilot Project is rehabilitating agricultural infrastructure, particularly rural roads and very small irrigation systems, and providing small credits to individual farmers for purchasing livestock and fertilizers. More than 120 rural infrastructure projects are under way in seventeen districts. The projects range from rehabilitation of roads and small irrigation systems to repair of schools and health clinics. In addition to their other benefits, these activities created thousands of jobs. About 35 village credit funds have been established, and 1,100 small loans averaging \$300 have been disbursed to farmers and small entrepreneurs. The program is to be expanded nationwide. (See the next chapter for a further description of the project.)

The Agriculture Sector Adjustment Credit (ASAC) supports the government's reforms in agriculture, particularly in pricing, privatization of state-owned agricultural enterprises, distribution of state farmland, and reorganization of the agricultural bank. ASAC provides a quick-disbursing credit to finance imports in the agriculture sector, as well as a credit line for private farmers and farmers' associations. It also finances technical assistance to the agricultural banking system.

Agricultural infrastructure has deteriorated because of chronic lack of maintenance, followed by destruction during the 1990-92 revolution. Between 1991 and 1993 the irrigated area decreased from 60 percent of arable land to about 11 percent. With less than 20 percent of rainfall occurring during the period from April through September, irrigation is essential for agricultural production in many areas. It is all the more vital now, since the inception of land reform, because of the



Smallholders in northern Albania talk about the wheat harvest with World Bank officers

urgent need to increase productivity on the small private farms that have emerged.

The main water sources consist of about sixty-five reservoirs (accounting for 42 percent of the water available for irrigation), pumping stations with lift irrigation (18 percent), and run-of-river schemes (40 percent). A major effort to put existing systems back into operation is planned through a proposed irrigation rehabilitation project currently being prepared for possible IDA financing.

Private sector activity is developing rapidly in agriculture-related activities such as output marketing, input supply, food processing, rental of tractor services, and workshops. However, private business competes on an unequal footing with state-owned enterprises, which until recently had privileged access to state-guaranteed credit and continue to receive the bulk of food aid shipments and donor-financed agricultural inputs. Lack of capital and of management skills also puts private firms at a disadvantage and can slow the development of private sector activities, particularly in rural areas.

Agricultural services, including access to credit, extension services, and research facilities, are prerequisites for the further transformation of the agricultural sector. The increasing

Preparing the Irrigation Rehabilitation Project

In Albania irrigation is needed in the dry months between spring and autumn, while drainage is required to prevent flooding in low-lying land during winter. The World Bank's Irrigation Rehabilitation Project, in preparation since the fall of 1993, concentrates on repairing the existing irrigation and drainage infrastructure and reorganizing the water distribution mechanism in selected high-potential districts. Among the goals of the project, scheduled to start in mid-1994, is to support the establishment of water user associations.

Albania's irrigation and drainage infrastructure is impressive in its coverage—about 60 percent of the arable land has been placed under irrigation and drainage since the beginning of this century, says Michael Koch, the World Bank's task manager for the project. However, inadequate maintenance and the social upheavals following the demise of communism in 1991 caused substantial damage to the systems, and in 1993 the actual irrigated area was a mere 11 percent of arable land. With simple and inexpensive investments of no more than \$500 per hectare, it will be possible to rehabilitate many viable systems in the fertile areas along the coastal plains.



"The real challenge for Albanians and us World Bankers is to ensure good maintenance of repaired systems in the future. Creating hundreds of local water user associations and reforming inefficient state irrigation utilities are the key tasks in order to achieve that goal. Luckily for us, the Albanians had already developed a draft irrigation code which we quickly helped to review and revise. This code now provides a good basis for the proposed Irrigation Rehabilitation Project; it clearly defines the gradually reduced role of government and the increased responsibility of farmers in irrigation management, which is precisely the way to go for the future."

Michael Koch, project task manager, World Bank

demand by private farmers for financing to purchase urgently needed inputs and mechanized equipment has so far been met largely by external assistance from many donors. In the past, formal credit was supplied by the Bank of Agriculture and Development, which has a network of 27 branches and 160 rural agencies. This bank is currently being liquidated. The

new Rural Commercial Bank (RCB) has been legally established as a commercially operating successor institution that aims at meeting the credit requirements of smallholders, traders, and the privatized agroprocessing industry. The RCB, which received its license in 1993, is being supported by the Agriculture Sector Adjustment Credit.

The research system in Albania's agriculture sector consists of seventeen research institutes that work on applied or basic research. Past research was commodity based, with no socio-economic analysis, and consequently has little relevance to the new farming environment. Research stations are run-down and lack essential equipment and machinery.

Banking for and on Small Farmers

"We are the first bank in Albania to work with European standards. The Bank management is free to make decisions on giving credits, and 98 percent of our credit goes to the private sector, mostly to smallholders and traders of agricultural inputs and outputs. The total amount of credit we provide is about 2 billion leks. Overdue loans are only 11 percent, compared with other banks, which have an average of 40 percent delinquency. Recently, we are trying to improve and increase services to our customers. For example, we are now able to transfer money abroad. We established relations with banks in Europe and the United States. The RCB has 35 district branches, about 160 agencies, and about 500 employees. Our network is the biggest in Albania, and we cover the whole country.

"Within our bank, we have six consultants financed by the World Bank, helping us in all areas of banking, from financial services, accounting, and credit to international banking, administration, and human resources. They work very hard and cooperate closely with the Albanian staff of the RCB. With the assistance of these consultants, we have made a lot of progress in one year. I appreciate very much our government's intention and the World Bank's assistance in restructuring the banking system. It is now our job, as bankers, to make this effort survive and deliver its results."

Orfea Dhuci, vice executive officer, Rural Commercial Bank

The Ministry of Agriculture and Food operates a basic agricultural extension network. In the past the role of this system was to ensure that farm production could meet centrally set production targets and to transfer technical recommendations from the research stations. The existing extension system has to be reoriented to take into account the new structure of land ownership and the emergence of private farmers.

The government will persevere in its efforts to establish an adequate legal framework for property rights and local administrative capacities for agriculture-related public sector services and to develop the private sector in agriculture. No area of the Albanian economy is more important for long-term viability of economic reform. The World Bank and the government will continue to finance agriculture-related investment projects to ensure sustainable progress in the sector.

Price Policy

To encourage a supply response in agriculture, Albania has adopted a medium-term price policy that the World Bank is supporting through the Agriculture Sector Adjustment Credit. The main objective of this policy is to ensure an efficient allocation of resources by increasing the prices for domestic products to approximate world market levels, sustaining the pricing of food aid at import parity levels, and eliminating direct subsidies on domestic products. In addition, private trade in agricultural products is being encouraged through the removal of price ceilings on privately imported goods, the elimination of export licensing, and the contracting of the processing and distribution of food aid to private operators. The new price policy is supported by privatization of state-owned marketing and processing enterprises. Increased private sector participation is expected to help restore the marketing and processing networks and provide incentives for increased agroindustrial production.

During the period 1989-91 domestic production of wheat fell from 613,000 tons to 270,000 tons, causing particular hardship because bread is the main staple food. For bread and

other staples, Albania became mostly reliant on international humanitarian assistance. At first, in an effort to avert widespread starvation during late 1991, food aid was either given away or sold at prices far lower than those of local products. Once an economic reform program had been adopted by the Meksi administration, the government began to sell food aid at world market prices, hoping to encourage production by domestic private farmers.

Agricultural output prices were liberalized in various stages between late 1991 and 1993. On January 15, 1993, all producer, wholesale, and consumer prices were liberalized, with the exception of prices for bread, wheat, and sugar beet. In July 1993 all prices were liberalized. In practice, however, market prices are heavily influenced by the prices at which food aid imports are sold. In June 1993 the government decided to raise the price of wheat provided through food aid to 16 leks per kilogram while raising the price of domestically produced wheat to 14 leks. This step has brought domestic output prices closer to world levels and has given millers an incentive to purchase wheat from domestic producers. The price of bread has consequently risen to cost-covering levels, while subsidies from the state budget protect the poorest families.

In addition to wheat, food aid shipments include vegetable oil, sugar, rice, meat, powdered milk, butter, cheese, and eggs. While consumer prices of food aid sugar and rice have been set higher than import parity levels, prices of meat and dairy products were set about 10–20 percent lower. The government intends to set food aid prices at import parity levels to avoid discouraging private imports, but because of health and nutrition considerations, it will do this gradually, over a period of two to three years.

Fisheries and Forestry

Among Albania's potentially important but often overlooked resources are fisheries and forests. Soil and climate conditions are ideal for the development of the 1.04 million hectares of forestland (38 percent of the total area), and Albania's 500



The fish market, Tiranë

kilometers of coastline and vast inland lagoons, freshwater lakes, and reservoirs offer opportunities for developing the fishing industry. Realization of this potential requires the adoption of a legal framework for administration, management, and environmental protection.

The main priorities of the government in the fisheries sector are to establish a fisheries management and protection service and to promote private investment in fishery enterprises and in local fish marketing facilities. Albania's sustainable annual marine fish catch is estimated at between 7,000 and 8,000 tons. By the mid-1980s the fishing industry exported about 3,500 tons of canned sardines and 2,000–3,000 tons of demersal (bottom-dwelling) species each year, valued at approximately \$10 million a year.

Environmental Protection and Management of Natural Resources

Albania's rich endowment of natural resources is threatened by inadequate protection and management. Partly as a consequence of meager industrial capacity in the past, the expansive coastlines and splendid mountains have escaped great damage; considerably less environmental destruction has occurred than in other Central and Eastern European countries. Nonetheless, past environmental mismanagement has led to soil erosion, deforestation, water contamination, and loss of biodiversity.

Post-Communist Albania understands the necessity of establishing and meeting standards for environmental protection. But resource constraints dictate that the country will have to focus on preventing further degradation rather than remedying past environmental damage. The government's strategy emphasizes strengthening the Committee for Environmental Protection and Preservation (CEPP) and the legislative and policy framework for environmental management.

The strategy includes short-term plans to eliminate subsidies for fuelwood, electricity, coal, and water, thereby curtailing irresponsible private and public use of the resources. In addition, the CEPP will draft legislation to encourage environmental protection, particularly in the areas of water quality, waste management, irrigation water, forestry, and coastal zone management. Longer-term components of the strategy include augmenting environmental monitoring through the CEPP, developing and implementing environmental policy, and executing oversight responsibilities for environmental protection.

More effective management will enable Albania to maintain its precious natural resources. Toward this end, the World Bank has assisted the government in preparing a National Environmental Action Plan. The plan, finalized in July 1993, has received several million dollars in donor commitments for follow-up actions.

Marine fisheries are concentrated at four main ports—Durrës, Sarande, Shengjin, and Vlorë. Privatization of the fleet of 115 boats should be completed in early 1994. (By mid-1993, 20 boats had been sold outright, and 45 had been purchased by their crews.) There is also an artisanal fishery that uses small boats and is organized at the district level. Some development

of inland fisheries and aquaculture has occurred, with five carp-farming enterprises covering 450 hectares, a smaller 4-hectare trout farm, and nearly 80 mussel-producing units in the Butrint Lagoon.

The situation in the forestry industry is somewhat more complex. Unchecked exploitation has led to environmental degradation in areas surrounding urban centers. During 1991-92 random and unregulated harvesting of trees took place as families relied on fuelwood to heat their homes. The serious erosion that resulted has permanently damaged and reduced the forest base, especially in the lowland shrub and coppice forests. Inaccessible forests in the highlands have suffered much less degradation and offer good potential for improved wildland protection and development of tourism. The challenge today is to protect the remaining forest resources and to plan for their future use.

The government's priorities will be the creation of a modern forest resource management service to oversee the efficient and sustainable use of Albania's forests, backed up by the privatization of forestry and wood-processing enterprises and the development of infrastructure. To buttress these reforms, the World Bank and the government are planning a forestry rehabilitation project to support the policy and institutional reforms in forest management and the development of the legal and institutional underpinnings for environmentally safe exploitation of Albania's forests. Other elements include the accelerated replanting of devastated forests, the protection of some areas containing rare trees, the privatization of forest industrial enterprises, and the expansion of Albania's forest research capabilities.



ALLEVIATING POVERTY AND SUPPORTING HUMAN RESOURCES

Even before the drastic output decline following the breakdown of the old regime, living standards for most Albanians were well below the levels in other Central and East European countries. In 1990 and 1991 massive social turmoil was responsible for the destruction of schools, health facilities, housing, and electricity and water distribution networks. Although the entire country suffered from diminishing standards of living during the transition, the two-thirds of the population who reside in the countryside endured the greatest hardships.

By March 1992, when the first non-Communist government was elected, poverty in urban and rural areas had reached unprecedented proportions. Within agriculture alone, for example, a cumulative drop in sector output of 28 percent was registered during 1990–91, evidence of the depth of the economic recession and a partial explanation for the food shortages, riots, and breakdown of general public order during the transition. Once installed, the new government acknowledged the immense challenges presented by far-reaching economic restructuring and the resulting social costs. To deal with this challenge effectively in Albania, transformation to modern

economic practices, particularly within the public sector, was required. Needs within the social sectors perhaps required the most attention.

Reforms in the social sectors have helped maintain a social consensus in favor of general economic reform. At the time of the government transition, the average Albanian was appalled at the quick economic and social disintegration of the country—a consequence, in part, of uncoordinated policies in the previous years. Widespread urban crime and scarcities of basic goods such as bread, meat, coffee, sugar, and clothing contributed to popular dissatisfaction.

Tackling the disparate needs of providing such necessities as food, housing, health services, and education to the population while sustaining social assistance programs and undertaking economic restructuring remains a major challenge for the Albanian government. Albania's agrarian economy provides the most important basis for alleviating poverty and ensuring a sufficient food supply. At the same time, social assistance programs must be overhauled and expanded to ensure a social safety net of last resort for the truly needy.

Two of the greatest accomplishments of the previous regime—practically universal access to primary health care and basic education—were undermined during the revolution. Many hospitals and schools were partially or completely destroyed, and parents kept small children out of school because of the lack of adequate facilities and so that they could work in new family businesses. During the transition the government has been concerned about rescuing health care and education from dilapidation. Together, the World Bank and the government have developed reform strategies for education, health, the social safety net, and poverty alleviation.

Early World Bank lending to Albania targeted poverty alleviation through revitalization of agriculture; the Critical Imports Project, the Rural Poverty Alleviation Pilot Project, and the Agriculture Sector Adjustment Credit were designed with these goals in mind. As agriculture began to recover, greater emphasis has been placed on the need to transform the labor market, develop social security, and rescue the edu-

cation and health sectors. The Labor Market Development and Social Safety Net projects, approved by the World Bank's Board of Executive Directors in September 1993, support efforts to institute effective policies in the sectors. In health and education, the World Bank first assisted with the development of sector strategies and now expects, through lending, to rehabilitate primary schools and rejuvenate primary health care.

Poverty Alleviation

The Critical Imports Project (CIP), Albania's first lending package with the World Bank, was designed to encourage domestic agricultural production, rehabilitate electricity service, and strengthen efforts to revitalize the economy and alleviate poverty. The project's agricultural component supported the government's recovery strategy, which, at the core, included measures to restore food security, promote the small private sector in agriculture, and repair basic farm infrastructure. As its title suggests, the Critical Imports Project provided basic inputs not produced domestically, such as fertilizer, high-quality seeds, plastic sheeting for greenhouses, and spare parts for agricultural machinery. Its objectives were to improve crop and animal production, repair irrigation and rural infrastructure, and encourage agricultural mechanization.

Prior to the March 1992 elections, food distribution, health and education services, and industrial and agricultural production had totally collapsed. The severity of the collapse—a result of manifestations of popular frustration over the government and the economy—underlined the importance of formulating a coherent poverty alleviation strategy. During the winter of 1991–92, disintegration in the cities was seen mainly in increased crime and in long food distribution lines. In rural areas, widespread destruction of government property was coupled with fatal food riots and hijacking of food distribution trucks.

Albania is largely a rural country; more than 50 percent of the population is employed in agriculture, and roughly two-

thirds of the population lives outside the major cities. The differences in living standards between less and more developed regions are minimal. Privatization of agricultural collectives began in mid-1991, with distribution of approximately 1.4 hectares of land to each former employee of the collectives. Although private and collective plots are still interspersed, the government perceived that even a partial privatization would give impetus to development of a private agricultural sector.

Feeding the population is a priority for any government, particularly in Albania following the devastating food shortages of the 1991-92 winter, when the country had become reliant on international food aid and foreign assistance for food distribution. With the growing season approaching, there was a window of opportunity for the country to begin weaning itself from international aid while revitalizing domestic agricultural production. The challenge was to provide sufficient inputs so that the new private farmers would begin growing food. The Bank (through its Critical Imports Project) and other multilateral and bilateral donors provided these inputs.

While the Critical Imports Project was still being implemented, the World Bank provided two additional credits for further developing agriculture and alleviating poverty: the Agriculture Sector Adjustment Credit and the Rural Poverty Alleviation Pilot Project. The latter, which became effective in April 1993, develops agriculture by promoting small-scale private farms, providing cash for operations, creating the conditions for a rural market economy, and repairing basic rural infrastructure.

The Rural Poverty Alleviation Project, which finances public works and a small-scale credit program, was designed to accommodate cultural nuances. After the decades of isolation, when villagers were even more completely cut off from the modern world than were other elements of the Albanian population, it was paramount to choose staff who could bridge the gap between the intelligentsia, with the organizational ability to implement the project, and the recipients of the loans on the village level. The village credit committees are elected and therefore enjoy the confidence of the villagers. Under the

project, regional demographics were carefully examined to identify the poorest areas, and an autonomous agency, the Rural Development Fund (RDF), was established to implement the project.

The RDF credit program organizes and finances small loans for income-generating activity in rural areas. Many of these loans have been used to purchase livestock; others have been used for agricultural inputs, trading enterprises, and handicraft production. The elected village credit committees are active in determining borrower eligibility, loan duration, and collateral. Village solidarity also helps ensure repayment.

Cultivating Hope in Albania's Rural Areas

"Our projects are grass-roots operations and demand-driven. We work directly with the village and commune councils in identifying the project areas and in actually implementing the projects. Once the projects are selected by the councils, our engineers prepare the technical and financial evaluations, discuss the results with the councils, and finally sign the contract. During construction, we assure the community administration that most of the work will be done by local workers, and in this way we provide employment for them.

"One major problem is that neither the community administration nor the people have had any experience in managing, supervising, or conducting a project for their own community. Everything was planned, financed, and carried out by the central government under the old regime. Therefore, people have had difficulties in owning the project, doing something for the community, and usually have had lesser commitment to the project. As a result, some projects that we intended to finish in three months lasted as long as six months. To address this problem, we decided to create some incentives, for example, by promising the community another project if they complete their ongoing project on time. Another problem is, of course, the scarcity of equipment that the communes or villages require. Infrastructure equipment is scarce in Albania in general, but it is even more difficult for the poor communes and villages in the north with no line of communication or transportation to find and deliver the equipment."

*Vladimir Malkaj, director,
Infrastructure Department, Rural Development Fund*

Reimbursements, which began in November 1993, have been 100 percent to date.

The project also finances the rehabilitation of basic rural infrastructure such as rural schools, water distribution, and village roads to alleviate poverty, inject cash, and create employment in the poorer areas. By the end of 1993 the RDF had started more than eighty projects, of which thirty had been completed. Currently, the RDF employs ten engineers and works in poor mountain areas of some twenty districts. In addition to World Bank financing, the project is cofinanced by the European Union and the Italian government.

Despite the great successes under the Rural Poverty Alleviation Project, large numbers of Albanians still want to move to urban areas, where living conditions, although often poor, are still better than in rural regions. As employment opportunities develop in urban areas over the next decade, still more Albanians are expected to migrate to the cities. The government has lifted restrictions on residency that were enforced under central planning, and the people are expected to take advantage of the freedom to choose their place of residence. Specific initiatives are therefore needed to alleviate urban poverty. In

“A Project of Hope”

Maria Nowak, who is on temporary assignment at the World Bank from the Caisse Française de Développement, has worked on replication of the well-known approach of Bangladesh's Grameen Bank in West African countries. Her experience has been particularly important to the success of the Rural Poverty Alleviation Project, for which she is task manager. The main idea of the project is to alleviate poverty in a proactive way, injecting cash resources into the economy and helping people break the imagination barrier created by forty years of isolation and central planning.

Says Ms. Novak, “Credit is a very powerful tool in this respect. The word credit is from Latin ‘to trust’; it not only provides the small capital people need to start new activities but also gives them confidence in their own initiatives. President Berisha called this project ‘a project of hope,’ which is a very apt description.”

anticipation, the government is formulating long-term strategies for developing urban private sector activities.

The Urban Works and Microenterprises Development Pilot Project, now in preparation, will address the changing needs in urban centers by extending credits, like those provided under the Rural Poverty Alleviation Project, for development of small enterprises in the cities. Other components of the project will include, among other things, establishing demonstration projects for microenterprise development and funding studies, training, and exchanges for municipal officials. The one-year pilot project will organize central institutions for project implementation and establish a credit system in selected municipalities. This project, targeting very small enterprises, will operate in tandem with the Labor Market Development Project, also formulated through cooperation between the Bank and the Albanian government.

The Labor Market and the Social Safety Net

Prior to the 1992 efforts at far-reaching economic reform, Albania had extensive entitlement programs, including generous pensions available at early ages, liberal unemployment benefits, maternity leave, and social protection programs for those incapable of working. Large transfers from the state budget maintained the relative balance of living standards throughout the country. Like other strict Stalinist countries, Albania did not have open unemployment, and during the transition unemployment soared from practically zero to 25 percent almost overnight.

Serious deterioration of the former system of social protection began with the labor unrest that brought down the government of Fatos Nano in May 1991. In July a social assistance law was promulgated that meshed social assistance and social insurance (or unemployment benefits). The law provided unemployment benefits to various social groups regardless of actual employment status. In addition, idle workers in state-owned enterprises received 80 percent of their former wages.

Because these measures failed to target social transfers properly, they were a burden on the state budget.

Although in Albania close family ties provide an informal social safety net, the Meksi government realized the need for revamping unemployment and social assistance programs. Furthermore, as Albania has moved from entirely state-controlled employment toward a market economy, significant amounts of the labor force have been shed from state enterprises, causing an increase in unemployment. With privatization of state assets and the beginning of international investment, demands on the Albanian labor market require new training measures for workers, retraining for workers from the former state-owned enterprises, and implementation of modern labor policies.

Working together, the World Bank and government officials have formulated a system to rationalize cash benefit payments. In addition, the government has initiated a system of block grants for cash benefit payments and has begun to develop a social security institute, provide policy advice, and modernize the social security system. Assistance for further development of social insurance and assistance schemes was furthered by approval of the labor market and social safety net projects by the World Bank's Board of Executive Directors on September 14, 1993.

A work force cannot be trained or retrained overnight. In mid-1992 the World Bank and the Albanian government began preparing strategies for modernizing labor practices. After more than a year, this work culminated in September 1993 in the approval of the Labor Market Development Credit, which bolsters policy reform and assists with the development of a strategy for modernizing worker training practices and retraining unemployed workers. Under the credit, an independent government agency known as the Training, Enterprise, and Employment Fund (TEEF) was established to channel public resources to projects proposed by enterprises and private entrepreneurs. Through the TEEF, entrepreneurs recruit potential workers and train them in the workplace. The work-

ers' salaries during the training cycle come from the TEEF, which is funded under the World Bank project. In return, the entrepreneurs recruit a percentage of these workers following the training period, and at that point employers begin paying the salaries of the newly trained workers.

As a market economy begins to develop, the TEEF is organizing small business clubs throughout the country. In the past, there were not even chambers of commerce in Albania, so the formation of these clubs is giving the new business leaders an

Empowering Women in Albania

Beginning in the Communist years, Albanian women have had access to all levels of education, and before the 1990-92 transition approximately half of the work force was female. But women were concentrated in lower-paying and less prestigious occupations, and their daily routine was monopolized by jobs and household chores. Traditionally, Albanian men have played only minor roles in family duties and child nurturing. For Albanian women, the challenge in the 1990s is integration across occupations and within traditional cultural boundaries. The economic transformation will continue to be difficult for women as employment opportunities and skills criteria shift from the requirements of state-mandated employment toward the private sector.

Most Albanian migrant workers in Italy and Greece are men, and a large percentage of them are from rural areas. Rural women have remained in the villages to tend the private plots of land and raise families. This return to traditional divisions of labor has exacerbated the difficulties of integrating women into the emerging market economy and ensuring their access to government positions. The government has instituted policies that will assist women in public sector employment and provide appropriate regulations for those in the private sector.

Several government initiatives have had a particularly important impact on women in the workplace. In May 1991, as part of the agreement that ended the strike which brought down the Nano government, workdays for women were shortened. By July 1993 the official workweek for all workers was shortened to five days, an action that gives women more time for their many duties. In addition, the government is seeking to increase maternity leave in 1994. In the long-

important forum for discussing issues of mutual concern. A pilot project for the formation of a "small business incubator," where office infrastructure is available for use by groups of entrepreneurs in the area, will be initiated.

Other components of the Labor Market Project will assist the government in establishing offices throughout the country to facilitate and modernize the payment and administration of unemployment benefit schemes and to train office workers in calculating these benefits and implementing the payment

term, as modern conveniences and attitudes begin to permeate Albanian society, traditional demands on women will likely diminish, providing greater personal freedom.

The World Bank is setting an example for other businesses, notes Resident Representative Kutlay Ebiri, by its active recruitment of women for high-level positions in the Tiranë office. Women employees include economists, project officers, and the liaison officer.



Traditional occupations: village woman spinning wool

plans. The project includes institutional development in both the central government and local benefit offices.

Under the centralized planning of the past, people were placed in jobs by the government, while job training and provision of social security were the employer's responsibilities. Full employment was maintained by the state throughout the 1980s, and although output decreased, the Albanian labor force continued to grow. Since 1990 open unemployment has increased rapidly, to approximately 30 percent of the nonagricultural work force. Unemployment will continue to be a problem through the mid-1990s as state enterprises scale back operations or close down as a result of enterprise reform and privatization.

The new private sector will only gradually be able to provide more productive jobs to absorb the surplus labor. As the country moves toward proper incentives and clear responsibilities, the government is focusing on implementing a system of social insurance under which contributions and benefits are rationalized and are linked to each other more practically. Better incentives and a modernized system of administration with individual contribution records are expected to enhance both the efficiency of social insurance and its fiscal viability. Although Albania does not wish to abandon past social insurance achievements such as sick pay, pensions, and maternity and disability benefits, the country is striving to provide these benefits in a more responsible manner. The Social Safety Net Project not only seeks to modernize collection and payment of social insurance but, on a larger scale, also assists the government in balancing resource constraints and workers' needs in a market economy. Finally, the project is helping the government to terminate superfluous benefits, such as widespread exceptions for receiving early pensions. (Although the legal ages for receiving pensions are 55 for women and 60 for men, the average pensioner today begins receiving benefits at age 53 for women and 57 for men as a result of the large number of early retirements.)

Responding to the social and fiscal challenges to welfare and employment, the government in April 1992 created a Ministry

of Labor and Social Protection. Albania, uniquely in Central and Eastern Europe, never had either a labor or a welfare ministry. The new ministry is the main focus for social and employment policies. Its ambitious agenda includes supervision of the reform of social insurance, the introduction and management of the new system of unemployment benefits, and the introduction of a wide range of active labor market measures, all new to Albania. Both the Social Safety Net Project and the Labor Market Development Project contain substantial components to assist the ministry in meeting these high expectations.

A further challenge to labor market reform concerns the former victims of political oppression. The Communist regime persecuted, imprisoned, or interned approximately one-seventh of the population for political purposes. For the vast majority of these people, political persecution was indirect, involving deprivation of educational and job opportunities. However, 50,000 to 60,000 Albanians were imprisoned or interned, and their reintegration into society continues to pose a challenge to the government. To respond to these needs, the Committee for the Ex-Politically Persecuted was formed with the mandate of coordinating and administering special assistance programs for this constituency.

Health Services

Since the 1950s, widespread access to primary health care in Albania has led to long life expectancy, low infant mortality rates, and low mortality rates in the 35-69 years age bracket, particularly in comparison with other countries similar in income levels and other demographics. These health indicators, comparable to those of other East European countries with much higher income levels, will be difficult to maintain because of the deterioration of health facilities and equipment, the lack of medical supplies, and inadequate training for health professionals.

While the large number of health facilities has made possible the provision of health services to almost all citizens, the

Rehabilitating Primary Health Care

To maintain health services in Albania, it will be important to modernize and rehabilitate the country's health service centers. "Community participation in rehabilitating health centers will underpin the entire project, and this component makes the [Health Rehabilitation] Project unique for Albania," says health project task manager Ellen Goldstein. "The project will be administered by district level managers and planners, yet communities receiving new health centers must agree to actively participate in the project as well." Other local responsibilities will also be included.

Under the credit, 100 primary health care centers will be rehabilitated in six districts: three in the north around Shkodër and three in the southern area around Vlorë. A national team of Albanian trainers, trained under a technical assistance component of the loan, will pass on their budgetary and specialized health services skills to local health administrators. Observes the task manager, "This will develop a local health management base where one previously did not exist."

requirements of the economic revitalization program underscore the importance of reassessing the entire health structure. Presently, the system is bloated with insufficiently trained personnel and inadequate facilities. The importance of maintaining ample facilities throughout the country cannot be overstated. However, fundamental restructuring of the sector has to be achieved within existing fiscal constraints.

The government is establishing a strategy that seeks to promote realistic and achievable targets for health standards. Primary health care, the most cost-effective means of achieving health targets, will serve as the foundation for health services. Rehabilitation of equipment for the health facilities will be undertaken according to whether they are appropriate and efficient. Goals to be supported by the World Bank Health Rehabilitation Project include strengthening the primary care system, restoring essential hospital functions, consolidating the network of referral hospitals, and making the drug production and distribution systems more competitive.

Through the mid-1990s a new health management structure will be instituted under which eight regional hospitals will

serve as the management centers for all health services in the region. Health center services will be standardized, health providers will be retrained, and health education programs will be strengthened. In addition, plans to improve the national specialty hospitals in Tiranë will be implemented after 1996. Special attention will be given to improving the medical school at Tiranë University.

The government will also seek to encourage private health service, as appropriate, over the coming years. Initially, private health service will be encouraged in dentistry, although dental services will be provided under the new government management schemes as well. Although cost recovery will be instituted for nonessential drugs, subsidies for essential pharmaceuticals will remain in place over the short term. For the coming years, domestic pharmaceutical production will be limited to those pharmaceuticals that can be produced economically in Albania, such as intravenous fluids and basic medical consumables such as cotton wool.

The ultimate target of the Albanian government is to ensure the equitable distribution of health services and the best possible health care. Since the 1950s strides in health standards have been a point of pride for Albania. The government intends to ensure that standards remain high and, at the same time, economically viable.

Education

Since 1990, with the opening of borders and the development of private business and private agriculture, the entire social fiber of Albania has changed. To supplement family incomes, large numbers of Albanian youths are working abroad instead of continuing their education, tending new private farms at home, or struggling to start private businesses. New liberties are encouraging greater freedom in educating students, but teachers' salaries are low and school facilities are in need of repair, contributing to the further breakdown of education.

Past successes in education were a consequence of the importance given to literacy and training under central plan-



Investments in health and education are investments in people.

ning. Investments in maintaining educational facilities were, however, inadequate, and the widespread destruction of schools during the 1990-92 revolution has exacerbated the desperate need for school rehabilitation. Since 1990 enrollment has dropped significantly at all levels of education.

As in all sectors of the Albanian government, resources are inadequate for rehabilitating school facilities, paying teacher salaries, and providing textbooks, laboratories, and other basic educational tools. The World Bank and the Albanian government have formulated a two-tier strategy that comprises components for curriculum development and facility rehabilitation in primary and secondary education, as well as for post-secondary (university and advanced training) facilities.

Because the potential funding is significantly below the levels required for quickly rehabilitating schools, the government has begun the revitalization process by initially targeting the most dilapidated facilities. Through the World Bank School Rehabilitation Project, classrooms will be refitted with new

window glass, heaters, furniture, and educational tools, on a prioritized basis. Initially, some basic inputs for school rehabilitation, including paper, chalkboards, and window glass for classrooms, were procured under the Critical Imports Project.

During the previous regime, the curriculum reflected the requirements and ideology of the Communist system. Although teaching has been depoliticized, the absence of new textbooks and adequate teacher retraining has been a hindrance to quick revitalization of education. New textbooks have been distributed for the 1993-94 school year, and the Ministry of Education plans to continue teacher training and improve recruitment procedures in the coming years.

Similar achievements in rescuing higher education have resulted from reorganization of postsecondary schools and universities, introduction of new textbooks and teaching materials, and emergency repair and rehabilitation of facilities. Although institutions of higher education will remain under the Ministry of Education in the short term, current plans envision giving the university system autonomy from the state as soon as that is financially feasible.



SUPPORTING THE DEVELOPMENT OF A PRIVATE SECTOR

In command economies, the use of inputs and the production of outputs are dictated by central planning authorities. The successful transition to a market economy in these countries depends on rapid privatization of state-owned enterprises and assets, coupled with the development of a commercial banking system to support the new private sector. Like other countries in the region, Albania is grappling with the privatization issue, but the extreme and autarkic nature of its old command economy has made privatization perhaps even more difficult in Albania than in other former socialist countries. The process has been all the more exacting because of the chaos in the state-owned enterprise (SOE) sector during the 1990–92 transition. This anarchy, caused by the government's inability to continue subsidizing inefficient enterprises, led to a total collapse of the industrial sector and to an unemployment rate of at least 30 percent of the urban labor force in 1990.

Albania has now designed strategies for rehabilitating the enterprise and financial sectors. Privatization efforts have moved forward for small and medium-size enterprises, and the government is seeking to develop practical methods for downsizing large enterprises, curtailing subsidies to enterprises,

and bringing interenterprise arrears under control. Within the financial sector, the government's strategy includes separating state banking activities from commercial banking, developing lending criteria, liberalizing interest rates, and supporting the development of private banking.

State Enterprise Sector

Archaic technology in Albanian enterprises was the norm during the Communist regime. Most industrial equipment was purchased from the U.S.S.R., China, and East European countries and was outmoded even for its day. After the 1978 break with China, little industrial equipment was purchased, as a result of the total isolation of the country and the dearth of foreign currency for buying modern equipment. Industries had to stumble along with equipment in desperate states of disrepair. But obsolete and neglected equipment is not solely responsible for the dilapidated condition of most Albanian enterprises. State planning agencies controlled enterprises' production, and managers had little discretion, except in the choice of methods for meeting centrally set targets under the five-year plans.

In 1991 the Albanian government began privatizing state assets. Initially, few restaurants, shops, taxis, or other service enterprises went to private citizens. To administer the privatization scheme, two bureaus were established by legislation: the Preparatory Commission for the Process of Privatization (PCPP), an interministerial body responsible for preparation of privatization cases, and the National Agency for Privatization (NAP), under the control of the Council of Ministers. The NAP was given regulatory and administrative functions, including the approval of privatization transactions. Both bodies established branch offices in each district of the country.

Many problems arose in designing and implementing the initial privatization program. With the abolition of central planning, control over the enterprises disappeared. In addition, there were widespread accusations that privatization transactions completed prior to the elections fulfilled only cri-

Rescuing an Industrial Sector in Trouble

As a result of a deliberate concentration on the industrial sector in the post-World War II era, industrial enterprises represent the largest segment of Albania's nonagricultural economy. Starting from a very small base, Albania experienced rapid industrial growth until about 1980. Between 1950 and 1975, in response to high rates of investment, total industrial output grew rapidly, although the quality and real value of industrial products were never put to an international market test. Over the past decade, growth decelerated substantially as a result of the closing of the economy and, after 1978, the cessation of all external assistance. During 1980-89 industrial production grew at less than 3 percent per year, and it fell by 40 percent in 1991 and 1992. In most industrial subsectors, output is a fraction of pre-1990 levels. A large number of factories have closed altogether or operate sporadically, and more than half of the public enterprise labor force has been dismissed.

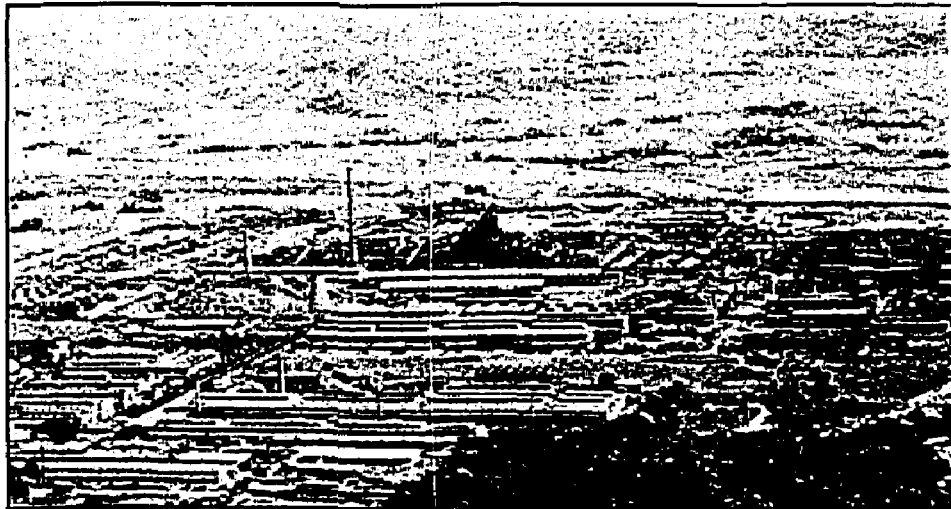
This sharp decline, of a magnitude not observed elsewhere in former socialist economies, is the result of a number of factors linked to the total collapse of Albania's extreme brand of central planning. Until 1991 all prices were set centrally, with minimal changes between five-year plan periods. All productive assets were owned by the state, and production was controlled through large state-owned enterprises (SOEs). Each SOE reported to a sector ministry that exercised control over investments, production levels, direction of trade, and utilization of surpluses. The system also led to inappropriate investment and endemic overmanning.

State enterprises are now legally autonomous entities, but in practice they often turn to the line ministries for technical and financial support. Following several recent reorganizations, the principal responsibility for the industrial sector is now vested unambiguously

teria of political expediency and that most of the privatized units were given to Communist sympathizers and apparatchiks. On April 24, 1992, the new government temporarily suspended the privatization process pending formulation of a long-term policy. New and revised legislation passed the parliament, and after a year of very slow progress, privatization gained full momentum in mid-1993 with the appointment of strong national and local leadership. By the end of 1993 more than 20,000 enterprises or groups with up to ten employees

in the Ministry of Industry and Trade. Construction enterprises are under the Ministry of Construction, and agroindustrial SOEs are under the Ministry of Agriculture. Other ministries, such as Transport and Mining and Energy Sources, also have enterprises under their authority.

The number of SOEs has been increasing over the past two years as large, multipurpose industries, particularly in agroprocessing and light industry, have been split up to improve manageability and prepare for privatization. Of the 2,000 or so SOEs now in existence, a large share are not currently operating. Moreover, the financial position of SOEs has deteriorated rapidly, leading to growing interenterprise arrears and bad bank loans. The decline of the state sector, however, is partly compensated by the rapid growth of small (largely informal) private companies in retail trade, handicrafts, construction, and services.



Metallurgical combine near Elbassan

had been privatized. Larger enterprises generally remained state owned because administrative capacity, information systems, regulation, and investment capital to run them privately were lacking.

The Albanian government has been working with the World Bank in formulating a privatization strategy that uses a multi-track approach. Very rapid privatization, particularly in the small-scale sector, is being encouraged to quickly achieve at least some growth in production. Small and medium-size

enterprises are being privatized with no budgetary financing. Meanwhile, the government is dealing with a limited number of large or particularly difficult enterprises with the help of an Enterprise Restructuring Agency (ERA) and is providing some financing through the state budget in the short run to solve the urgent problems of these enterprises. These large companies are being analyzed case by case and either closed or privatized, depending on their specific conditions.

Privatization of Small and Medium-Size Enterprises

The government has privatized small units and many medium-size enterprises. A 1991 law on privatization permitted the rapid privatization of small enterprises with a maximum of about ten employees, primarily in the fields of retail trade, services, and handicrafts. Most of these were sold directly to employers at advantageous prices. In addition, in May 1993 the Council of Ministers issued Decision 248, which established procedures for the privatization of medium-size firms with fewer than 300 employees and with a maximum book value of \$500,000. By the end of 1993, according to statistics provided by the NAP, of 1,200 small and medium-size enterprises, more than 700 had been privatized under this measure. These privatized enterprises are highly visible in Tiranë and other major cities. A large majority were sold directly to employees at book value, often at a fraction of market value. In recent months, book value has risen with inflation, and the NAP has increasingly relied on auctions, particularly for the more attractive units. Vigorous privatization efforts are expected to continue during 1994.

The privatization of small and medium-size enterprises has proceeded rapidly and successfully, but, as elsewhere in Eastern Europe, the process is inevitably controversial. Privatizations in 1991 and early 1992 lacked transparency and fairness as a result of the confiscatory practices and preferential positions of the former *nomenklatura*. Some beneficiaries of privatization have earned large profits by Albanian standards, causing considerable resentment. Although under Decision

248 auctions were to be the main method of privatization, they have been used less than 10 percent of the time so far. Most enterprises were sold to a single interested party because there was only one bidder, or were sold to employees directly. "We had to break the deadlock that had stopped privatization in 1992," says Bashkim Kopliku, deputy prime minister for economic reforms. "Decision 248 took account of Albanian realities and allowed us to move ahead very quickly."

Selling SOEs to a single bidder is not necessarily the way to ensure the highest selling price. However, revenue raising is not the most important consideration. The method used in Albania has achieved the fastest possible privatization, allowing the government to divest itself of enterprises and units requiring budgetary support and thereby freeing funds for use in public investments and social services. In an effort to accelerate the next round of privatization, the government is preparing a new legal framework to encourage greater participation and maximum public support for the process.

Privatization of Nonagricultural Land

In an effort to compensate for the inefficient practices of the past and to avoid erosion of public support for privatization, in April 1993 the parliament passed a law on restitution giving former owners of nonagricultural land the right to purchase the buildings sitting on their former property. (Compensation for former owners of agricultural land is discussed in the chapter on agriculture.) If the buildings sitting on this land have already been privatized, the law creates co-ownership between the landowner and the new building owner. The building owner leases the land for two years from the former owner at a rate set by law, after which time the owners must make their own commercial arrangement.

Several outstanding problems concern the restitution of properties privatized before enactment of this legislation. Since no provisions for exclusion of these properties exist, uncertainties over ownership of previously privatized properties are causing confusion and, in some instances, reversal of

early privatizations. According to the law, former owners are given six months to register their claims, after which they will only be entitled to financial compensation. However, when there are justifiable reasons, the law provides for an extension beyond six months. That the term *justifiable* is not defined in the law further complicates privatization.

It is estimated that about 60 to 70 percent of all privatizable assets will be privatized through restitution. Following the settlement of restitution claims, privatization should move forward rapidly.

Restructuring Large Enterprises

Most of Albania's industrial sector will not be viable without restructuring and significant downsizing. For large enterprises (those with more than 300 employees or book value of more than \$500,000), immediate privatization is unlikely because running them on a commercial basis would imply mass layoffs. The state will have to consider case by case particularly problematic enterprises, which include large industrial and mining complexes with excessive labor forces and industries that may be able to provide critical, low-cost inputs to private and public enterprises.

A comprehensive framework for privatizing large enterprises has yet to be developed. In mid-1993 the government addressed the issue by establishing, with assistance from the World Bank, the ERA, which is intended to be a short-lived organization that reports directly to the Council of Ministers. The ERA has identified thirty-two enterprises as the key problem cases requiring managerial and financial assistance prior to privatization. The ERA, which is financed through the budget as a discrete expenditure, will be closed down after it has accomplished its task. The goal is to restructure these selected enterprises with the aim of achieving more efficient operation within a reasonable period of time. Eventually, those enterprises with good potential to become competitive will be privatized with the help of foreign investors. Those that have no future will be liquidated, and the layoffs will be dealt with in

an orderly way. Public enterprises operating in the utilities, public works, and transport sectors are likely to stay in the public domain for the near future. The remaining large enterprises, together with the medium-size enterprises mentioned earlier, will be privatized without further budgetary outlays.

The ERA began its operations at the end of 1993 and by March 1994 had built a competent team of Albanian experts supported by external advisers. The government has selected textile, chemical, electromechanical, and consumer goods enterprises, as well as coal, iron, and nickel mines, for restructuring under the ERA. These enterprises will be either closed or considerably downsized during the restructuring process. In an effort to avoid creating incentives against privatization—for instance, by giving the greatest amount of public support to the worst problem enterprises—any access to ERA resources will be accompanied by layoffs or reductions in wages. Restructuring plans for some ERA enterprises are being prepared, and implementation is to start in mid-1994.

Genc Çelo, deputy chairman of the ERA, thinks that the main problem with privatization is a social one:

These large enterprises employed hundreds of workers. For instance, the coal mine in Valias near Tiranë is not likely to survive, since it produces low-calorie coal, and there are three other coal mines in Albania that produce good-quality coal. The situation is certainly a tough one, since the factory employs 1,200 workers. Also, it is politically and historically difficult to simply close down this factory, since its workers played an important role during the spring 1991 labor unrest that resulted in the fall of the Communist government. However, we think that the other job opportunities in the area, such as the reconstruction of the airport and the Durrës-Tiranë highway, will help ease the unemployment problem in Valias.

If privatization of large enterprises is to succeed, administrative resources need to be used more effectively. In mid-1993 the government put in place a high-level governing board for the NAP to provide interministerial policy coordination. The

NAP's board members are appointed by the prime minister, and the board is chaired by the deputy prime minister responsible for economic reforms. Pending parliamentary approval, the PCPP is to be merged into the NAP, which will further strengthen the privatization authority and make the best use of the available administrative resources.

Enterprise ownership rights must also be clearly defined. Currently, there is no consistent ownership control over the SOEs and no systematic reporting by these enterprises. In July 1992 a state enterprise law that restricts the control of ministries over the SOEs was passed. However, in practice, many state enterprises still do not exercise their legal autonomy. For instance, out of habit they request ministerial agreement even for relatively minor decisions or ask for financial support so that they can continue to operate. Moreover, the law contains no reference to the possible use of outside directors, no clear procedures for the transformation of SOEs into private enterprises, and no definition of the rights of the state as owner. The government has taken important steps to improve the management of some SOEs—for instance, by replacing and improving many top enterprise managers—but these efforts have lacked clear criteria and transparency. SOE managers' accountability for ownership and control of their enterprises without reliance on government financial support is now being established by the government in cooperation with the World Bank.

Interenterprise Arrears

Under the previous regime, the government financed enterprises through the banking sector, irrespective of their creditworthiness. Since the banks did not need to consider whether the loans would be repaid, a large part of these loans went into arrears. In 1992 the government, increasingly aware of the risks of lending to nonviable enterprises, took steps to enforce financial discipline and to reduce significantly the number of new credits.

During 1992 many state enterprises resorted to financing their activities largely through interenterprise credits because of the restrictions on budgetary subsidies and credits from the banking system, together with the deep decline in production and the rise in wage costs. Interenterprise arrears accumulated as invoices that could not be paid for lack of funds, and the banks decided which invoice to pay when funds became available in the account of an SOE. By the end of October 1992 the arrears had grown from virtually zero to more than 13 billion leks. This trend caused paralysis in the payments system. In early 1993 the government took steps to clear arrears and discourage their further growth, primarily by instructing the banks to change their payment mechanism and to stiffen their lending criteria. As a result of these measures, arrears grew at a slower pace, to 16 billion leks at the end of 1993. A number of state enterprises now seem to be requiring cash payments for sales to other enterprises. However, there is some evidence that interenterprise arrears have started to accumulate outside the banking system.

Challenges for the Enterprise Sector

Inevitably, public loss makers will receive public funding, either through the budget or through the banking sector, for as long as they operate. The government therefore needs to concentrate on privatizing as many enterprises as possible and to make absolutely clear which of the remaining state enterprises will be funded by the budget. Furthermore, the government should ensure that public financing of state enterprises will be subject to an explicit budget constraint and that public resources will be distributed only to the enterprises that are of the greatest economic, social, and strategic importance. Most other enterprises will be responsible for their own performance and financing, and no pressure on their behalf will be applied to the banks. As a result, the state-owned banks will be likely to operate on a more commercial basis than before,

with clearer lending criteria and under constraints that will provide incentives to focus on more creditworthy enterprises, public and private.

Developing a Financial System

Like the enterprise sector, Albania's financial sector must undergo fundamental changes. A significant effort is required to develop financial sector infrastructure, institutions, and policies and programs and, most importantly, to train individuals. Existing institutions need to be modernized, and the operating environment needs to be made conducive to the emergence of new banks.

Under the former centrally planned regime, the Bank of Albania undertook all central and commercial banking activities and operated as a financial institution. In this system, bankers were mere bookkeepers, transferring budget funds to state enterprises. The whole economy was state financed; so-called loans were, in the end, drawn from and repayable to the state budget, and there was no need to assess a borrower's creditworthiness or actual ability to repay a loan. The commercial banking departments in the central bank served only to ensure that credit reached those deemed worthy by the politicians and planners. Consequently, present-day banks are extremely weak in core banking functions such as credit risk analysis, loan collection, and provision of services.

In spite of restructuring efforts over the past three years, development of a viable commercial banking system has been relatively slow. Many of the factors hindering this process are problems inherited from the years under a centrally planned banking system. In the past banks made large loans to troubled SOEs, and with the collapse of SOE output, a large part of these loans went into arrears and virtually all the assets of the banking system were wiped out.

In early 1991 the banking system was restructured from a monobank to a two-tier system. Currently, the Bank of Albania is an independent bank that handles central banking functions such as supervision and monetary control. The Savings

Bank is dedicated to mobilizing household deposits, and the National Commercial Bank lends to and mobilizes deposits from industrial and commercial enterprises. The Bank for Agriculture and Development, which supported agricultural state enterprises, is now in liquidation. In October 1993 the Rural Commercial Bank was legally established as its successor; the new bank, which is supported by the World Bank's Agriculture Sector Adjustment Credit, operates on commercial principles and provides credit to private farmers and other rural entrepreneurs.

In dealing with the state-owned banking sector, the first step taken by the government was to remove bad loans to SOEs from the books of the banks. Then, in July 1992 banks were instructed to lend only on strictly commercial criteria and at their own risk. In late 1992 the government agreed to forgive outstanding SOE debt incurred prior to July 1992. When inter-enterprise arrears accelerated—in large part due to enterprises' difficulty in obtaining bank credit—the government again acted decisively to stop the practice of using payment orders insufficiently backed by funds as a way for enterprises to obtain credit. However, in late 1993 a government decision to extend public guarantees on bank loans to state enterprises encouraged banks to continue lending to nonviable enterprises. At present, therefore, the banking sector is still burdened with a large stock of nonperforming assets, mostly bad loans to state enterprises. The government plans to issue to the banking sector bonds for about 10 percent of aggregated commercial bank assets. These bonds will replace the enterprise obligations and thus will compensate and recapitalize the banks, under the condition that banks use market-oriented criteria for lending. Also, no more government guarantees will be extended except in connection with onlending of foreign credits. In the case of the Bank for Agriculture and Development, for instance, financial restructuring started with the identification of bad loans made to now-dissolved state farms and liquidated agricultural cooperatives. The bad loans and the corresponding liabilities are being taken off the bank's books and covered through government bonds. The remaining

Reform in the Enterprise and Banking Sectors

"The reforms to be supported under this project are crucial to the growth of the Albanian economy. Now that the government has successfully stabilized the economy, structural reforms must be rapidly put in place to provide the framework for growth. The major principle of the strategy pursued in this area is that reforms in financial and enterprise sectors have to proceed concurrently. Therefore the [Enterprise and Financial Sector Adjustment Credit, or EFSAC] is a multi-objective operation dealing with interdependent enterprise and financial sector problems."

Stanislas Balcerac, task manager, EFSAC



With privatization and restructuring already in process, the EFSAC will provide quick-disbursing funds for balance of payments assistance in support of the government's reform program in the enterprise and financial sectors. In the enterprise sector the EFSAC will support implementation of privatization strategy and the restructuring of large problem enterprises under the ERA. In the financial sector, the World Bank, together with the IMF, has so far given priority to building up the central bank as a supervisory body in the banking sector and the chief debt-negotiating entity. The EFSAC will now support the overall development of banking infrastructure, such as the accounting framework, supervision and regulation, a modern payments system, and the institutional strengthening of the banks, through support for bank staff training and improvement of the legal framework.

Through the Technical Assistance Project for Economic Reforms, the Bank is also providing institutional support to the agencies involved in the proposed EFSAC to help ensure that appropriate arrangements are in place to implement the enterprise and financial sector adjustment program. Startup activities for the EFSAC project are under way.

good assets have been transferred to the new Rural Commercial Bank, which is now offering new loans to private farmers.

Despite structural weaknesses concerning commercial bank assets at the Bank for Agriculture and Development and the National Commercial Bank, deposit mobilization has increased

for the commercial banks, reflecting continuing confidence that deposits held with banks are safe. This is particularly true in the case of the Savings Bank deposits, for which the state provides an implicit guarantee of liquidity.

Interest rates, which were highly negative in real terms in 1992, have also been reformed. Under the existing system, the Bank of Albania sets the floor on deposit rates and provides guidance on lending rates. As a result of sharply lowered inflation rates, in July 1993 interest rates were lowered. In the future, interest rates applied by private banks will be wholly determined by market forces.

All state-owned banks in Albania today face the need for radical changes to upgrade the basic banking skills of their staffs: banks are now at risk when they lend money, and this is a new and previously unknown responsibility for them. Albania is virtually the only country in the world with practically no domestic private banks, and with most private lending in the informal sector. The absence of an appropriate regulatory framework has been a key obstacle to the development of private banking. Clear and fair criteria to encourage private entrants are being developed and are expected to be implemented in 1994. The interbank market is currently administered largely by the Bank of Albania; a market of bonds and overnight securities does not yet exist. The World Bank EFSAC will support government efforts to establish the proper supervisory, regulatory, and infrastructural support for an interbank market in which banks will borrow and lend at market rates.



The Albanian financial system still lags behind international standards. However, in comparison with the situation of only a year ago, the achievements so far are promising, particularly the establishment of the Rural Commercial Bank, reform of interest rates, and increasing deposit mobilization. The real challenge is to establish a system of small and medium-size private banks that can mobilize deposits and lend to newly

privatized enterprises. This can be done only when the appropriate banking infrastructure—regulations and supervision, information systems, an accounting framework, an operational payments system, and training—is in place. In the meantime, the government will strengthen the state-owned commercial banks through extensive training of the staff, intensify competition through the provision of incentives for the entry of new private financial intermediaries, and build up the infrastructure required for a modern banking system.



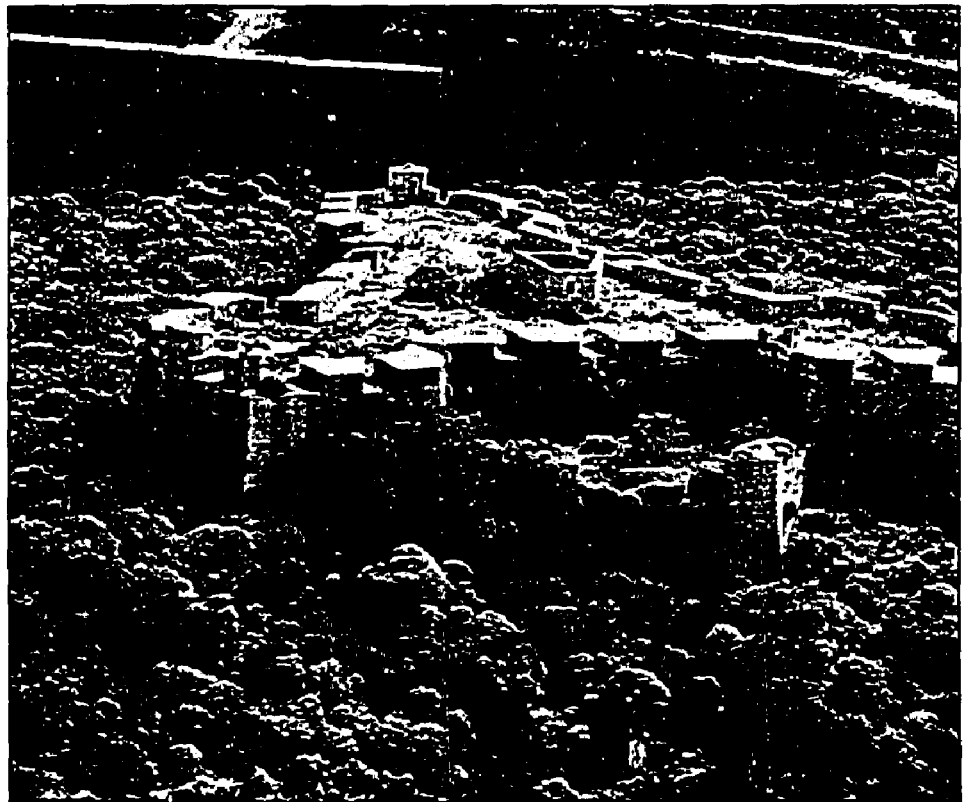
LOOKING FORWARD

The first two years of economic reforms have produced remarkable results for Albania. With its early successes, particularly in stabilizing the economy, achieving low inflation rates, privatizing housing, and emboldening private agriculture, Albania can look toward the twenty-first century with aspirations for prosperity and integration into Europe. These successes are providing a base for general economic recovery.

Contributing to the social consensus that makes possible continued reform is the concrete evidence that Albania's leaders are fulfilling their promise to integrate their country into Europe. For the public, visible changes in the country are a sign that the isolation and disintegration of the past are over. Imported consumer goods, previously a rarity, are now accessible to those who can afford them, and new shops carrying these goods have been established in the major cities. Not only do these goods serve as incentives for the new entrepreneurs, but they also are indicative of the opening of Albania. The tangible signs are most important for the innumerable Albanians who were persecuted under the previous regime and for the ordinary citizens whose only sight of the outside world was through the Italian and Yugoslav television services (although these, too, were officially prohibited).

The new shopkeepers and other entrepreneurs who form a small but growing middle class will serve as a foundation for economic development. The prospects are bright for the development of Albania's abundant natural resources, including its great potential for tourism, favorable location near the heart of European markets, and young, literate, and progressive population. Encouraging foreign investment is a priority for further integration; the development of institutional skills, incentives, and an appropriate legal framework for foreign ventures will require a sustained effort by authorities.

The recovery thus far has been substantial, but many challenges remain for the future. Among these concerns are completion of the privatization process, renegotiation of foreign debt, improvement of tax administration, and maintenance of the stabilization program. In addressing the challenges to eco-



The castle of Ali of Tepelenë. With its historic sites and magnificent scenery, Albania is a fascinating destination for tourists.

conomic development, the Albanian government and the World Bank have agreed on a lending program targeting the most important sectors of the economy and general economic stabilization; of course, much depends on progress in the individual sectors. Some reforms will be more successful than others, which can lead to changes in the composition of the lending program. Meanwhile, the Bank is trying to help accommodate the most pressing needs in the economy, particularly in institutional development and infrastructure.

Successes

In all aspects of economic and political life, Albania has started to build from scratch the institutions required for an open, pluralistic, market-oriented society. With great fortitude, it has implemented an ambitious economic stabilization program that is yielding positive results.

Within the first year of economic reform, Albania met all conditions for standby arrangements with the IMF—a feat not matched by many other transitional countries in Central and Eastern Europe. In 1993 Albania achieved 11 percent growth of GDP, following three consecutive years of drastic decline. This rate of growth was the fastest of any European economy. The budget was brought under control, while agricultural output and private sector activity increased. Foreign exchange reserves have risen, and the lek has appreciated by about 30 percent since the institution of the freely floating exchange market. No one could have predicted that the poorest of all the post-Communist countries of Europe, the one with the most excessive Stalinist past and the most isolated from the outside world, would be able to generate such a dramatic turnaround so quickly.

These successes are attributable to early and decisive economic actions by the government. Starting in April 1992, drastic economic stabilization measures were taken: the budget deficit was reduced, strict monetary targets were enforced, automatic extension of bank credit to state enterprises was curtailed, legislation formalizing a two-tier banking system

was adopted, trade was liberalized, and privatization in agriculture and housing was organized and completed. Most artificially controlled prices, with the exception of those for basic consumer goods, were freed. Although initially prices increased dramatically, they then stabilized. Albania stopped the high inflation that threatens so many countries in the region. Simultaneously, the currency was floated, private exchange transactions were legalized, and all current account transactions were liberalized.

Agricultural reform has been the centerpiece for economic reform, and successes in the agricultural sector have been among the greatest in Albania thus far. In 1992 agricultural production increased by 18 percent as a result of privatization and restoration of basic agricultural infrastructure. Growth in the sector is expected to continue at high levels in coming years. On July 1, 1993, the government raised the price of wheat to near world market levels and increased bread prices to cover costs. In less than one month these actions began to encourage greater private sector activity in agriculture.

Three years ago the Albanian government began privatization of small and medium-size enterprises. Officials anticipate that through a combination of privatization and restitution of property to previous owners, most state assets will have been transferred to the private sector by the end of 1995. Housing privatization began in May 1993 and was 97 percent complete by December of that year. As a result of the emphasis on privatization and the absence of government restrictions on private business activities, a new private sector is blossoming. The speed of privatization in Albania is indicative of the government's desire to limit its involvement in production and turn toward a regulatory role.

Early macroeconomic successes are in part attributable to the important international donations that followed the thawing of tensions with Western nations after the fall of communism. Foreign assistance—particularly from multilateral organizations, including the European Union, the European Bank for Reconstruction and Development (EBRD), the United Nations, the World Bank, and the IMF, as well as through bilat-



Roadside private enterprise

eral contributions—has allowed increasing investments in human and physical capital and has reinforced successful stabilization. Stabilization has been encouraged by the influx of foreign currency sent to family members by Albanian workers abroad, primarily in Greece and Italy.

Vigilance on the part of the government is required for building these initial successes into long-term achievements.

Many challenges will have to be overcome to consolidate the transition. Popular support for a market economy and the government's courage in adopting the measures needed for a rapid transition will be the two essential elements for success.

Challenges

To meet the next stage of challenges, the Albanian economy must be steered onto a sustainable growth path, and major investments in economic and social infrastructure must be carried out. This will require steady dedication on the part of Albanian authorities and continued external support. The exceptionally good performance of the economy in 1993 provides a great opportunity for Albania. Attitudes have changed, and there is now a sense of optimism that was totally absent in 1991 or early 1992. Albania can now harness this new energy to launch the next phase of reforms: instituting an effective system of taxation, further strengthening the budget, downsizing the old industrial sector, attracting new industries, developing the financial sector, utilizing Albania's natural resources, protecting the environment, maintaining social services, and improving public administration.

In order to consolidate economic stabilization, budgetary revenues and expenditures must be modified to reflect the new structure of the economy and the new role of the state. To finance public investments in infrastructure, social services, and the civil service, the government must have the ability to raise revenues through new and more efficient tax administration. The government's main tax base under communism—the state enterprise sector—is shrinking quickly with privatization. Although the new private sector is growing rapidly, it mostly consists of small unregistered businesses that do not yet contribute to tax revenues. The integration of new businesses into the tax system will pose a great administrative challenge for the government. With weak capacities to administer taxes and an increase in revenue needs, authorities must be vigilant in collecting revenues.

Albania's Stabilization Program

"I had the impression that the Albanians were *biting the bullet* up front on their economic policy. From the beginning, the authorities were willing to take difficult decisions on liberalizing prices, particularly the price of staple foods like bread, as well as liberalizing trade and cutting subsidies to state enterprises. The measures were risky but have paid off because one year later we began to see a strong supply response, particularly in the agriculture sector.

"The greatest success for the Albanians so far is to have managed stabilization with so little implementation capacity. Paradoxically, with the crisis period now over, Albania has entered the most dangerous period because the sense of urgency is now gone, yet many important steps must still be taken, especially within enterprise and financial restructuring, tax reform, public investment programs, and social assistance transfers. The payoffs from these reforms are likely to materialize in the medium term only, while some of the costs will have to be borne up front. Yet there is no other way to maintain the hard-won benefits of the recent stabilization."

Dominique Dwor-Frecaut, country economist for Albania, World Bank



International support for Albania's privatization efforts: the First Donors' Meeting on Albania, Tiranë, July 1992

Shrinking the size of the public sector and redefining the most urgent needs in public investment and civil service reform have been priorities for the transition. The concept of private property and privately owned businesses is new to Albania. In the past, extreme centralization permeated all aspects of society; now the development of a viable private sector is a prerequisite for successful transition. Another task of the government is to rationalize social insurance and cash benefit programs by targeting these entitlements to the most needy citizens. Similarly, budget transfers to state banks and enterprises should take place only within strictly defined budgetary limits. And while, from a budgetary perspective, substantial cuts in the total civil service wage bill are necessary, it is equally necessary for the government to provide good salaries to those civil servants who work hard and effectively.

A successful tax system is required in order to raise revenues to support the budget. A legal framework for the tax system is being promulgated by the parliament, but without rapid achievements in collecting taxes, the government risks losing its ability to finance public investments and maintain social services. Foreign assistance can alleviate these problems for only a short period of time while the government establishes effective methods of tax collection.

Although privatization has accelerated the downsizing of the state enterprise sector, the government acknowledges that privatization alone will not solve the problems of all state enterprises. Consequently, a number of the biggest loss makers among state enterprises must be closed down. The arduous process of restructuring particularly problematic enterprises is beginning, with only some of these units being good privatization prospects.

Establishing an effective new banking system will support the development of the private sector and create a foundation for structural reform of the economy. At the beginning, Albanian authorities concentrated on breaking apart the State Bank, which undertook all central and commercial banking functions. In the first year, the Savings Bank, the Bank for Agriculture and Development, and the National Commercial

Bank have emerged as state-owned commercial banks, and some banks have been established as joint ventures with foreign capital. In October 1993 the new Rural Commercial Bank received its license under the general Banking Law as the successor to the Bank for Agriculture and Development; operating on commercial principles, it provides financial services to agricultural and other rural customers. Although great progress has been achieved in the financial sector, many challenges remain, including the privatization of commercial banks, development of modern banking expertise and infrastructure, and introduction of regulatory authority over the financial sector.

Because the change of economic regime has been very rapid and there has been no prior experience with decentralized economic decisionmaking, the needs for reform are enormous, covering all sectors of the economy. Albania has abandoned central planning but does not yet have the institutions, expertise, or infrastructure required to be a well-functioning market economy. Furthermore, the implementation of reform is constrained by the limited administrative capacity within the government and by the low level of income per capita, which makes the population particularly vulnerable to the costs of adjustment. Substantial external resources will be required in the immediate future to alleviate the burden of adjustment on the most vulnerable segments of society.

The speed with which Albania consolidates economic success is predicated on continued donor support and foreign investment, two factors that Albania and the World Bank are trying to address. Efforts to coordinate international assistance should be aided by Albania's public investment program, which establishes priorities for donor support for investment projects. The government also welcomes foreign private investment and is establishing the necessary legal and institutional frameworks to facilitate it.

Looking toward the future, the greatest challenges are to build the infrastructure needed to accommodate a modern market economy, sustain economic stabilization, and provide a legal and social environment that can foster private economic

activity. In meeting these challenges, the dedication and perseverance of the authorities as they work to rebuild the country are central to future prosperity.

Together, Albania and the World Bank have embarked on an exciting journey. The early successes achieved in the 1992-94 period are a good start. Much effort and tenacity will be needed to build on these foundations and establish the rapid, self-sustaining growth that alone can bring prosperity to the Albanian people.

ALBANIA: BASIC COUNTRY DATA

Area: 28,748 sq. km

Agricultural land (1992): 11,585 sq. km

GNP per capita (1993): \$422

Population (1992): 3.4 million

Urban population as a percentage of total (1992): 36

Projected population in 2000: 3.9 million

Population density (1992): 118 per sq. km

Population density of agricultural land (1990): 463 per sq. km

Population growth rate (1991): 2 percent

Urban population growth rate (1987-92): 2.7 percent

Life expectancy at birth (1992): 73 years

Crude death rate (1990): 5.6 per thousand

Infant mortality (1992): 32 per 1,000 live births

Population per physician (1990): 731

Hospital beds per 1,000 inhabitants (1990): 5.8

Secondary school enrollment (1992): 45 percent of relevant age cohort

Illiteracy rate of population over age 10 (1989): 7.9

Newspaper circulation (1990): 42 per 1,000 population

Labor force (1992): 1.7 million

Female share of labor force: 52 percent

Sources: Albania, Directorate of Statistics; World Bank and IMF staff estimates.

